

AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1995

Accession For	
NTIS CRA&I	<input checked="" type="checkbox"/>
DTIC TAB	<input type="checkbox"/>
Unannounced	<input type="checkbox"/>
Justification	
By	
Distribution /	
Availability Codes	
Dist	Avail and/or Special
A-1	

**The Congress of the United States
Congressional Budget Office**

NOTES

Unless otherwise indicated, all years referred to in Chapter 2 are calendar years, and all years in other chapters and Appendix A are fiscal years.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

Numbers in the text and tables of this report may not add to totals because of rounding.

Preface

This analysis of the President's budget for fiscal year 1995 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policies in terms of changes from the Congressional Budget Office's (CBO's) baseline budget projections for 1995 through 1999. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

This report was prepared by the staffs of the Budget Analysis, Macroeconomic Analysis, and Tax Analysis divisions under the supervision of C.G. Nuckols, Robert Dennis, and Rosemary D. Marcuss. James Horney wrote Chapter 1, with contributions by Richard A. Kasten, Kathy A. Ruffing, and Paul N. Van de Water. Chapter 2 was written by Adrienne Kearney, with research assistance from Laurie Brown. Michael Miller wrote Chapter 3, and Kathy A. Ruffing wrote Appendix A. The baseline revenue estimates were prepared under the direction of Richard A. Kasten. The estimates of the President's revenue proposals were prepared by the Joint Committee on Taxation. The principal contributors to the revenue and spending estimates and analyses are listed in Appendix B.

Paul L. Houts supervised the editing and production of the report. Major portions were edited by Paul L. Houts, Sherwood D. Kohn, and Leah Mazade. Christian Spoor provided editorial assistance during production. The authors owe thanks to Marion Curry, Janice M. Johnson, Linda Lewis, and L. Rae Roy, who assisted in the preparation of the report. Kathryn Quattrone and Martina Wojak-Piotrow prepared the report for final publication.

Robert D. Reischauer
Director

April 1994

Contents

ONE	THE PRESIDENT'S BUDGETARY PROPOSALS	1
	Deficit Projections 1	
	Discretionary Spending 5	
	Nondiscretionary Spending 11	
	Revenues 14	
	The Administration's Health Proposal 14	
TWO	COMPARISON OF ECONOMIC FORECASTS	19
	Short-Term Outlook 19	
	Medium-Term Projections 24	
	Economic Implications of Health Care Reform 27	
	Effect of CBO's Economic Projections on the Administration's Budget 27	
THREE	THE ADMINISTRATION'S DEFENSE BUDGET	29
	Priorities in the Current Request 29	
	The Risk of Higher Inflation 31	
	The Risk of Not Cutting Infrastructure 33	
	Future Adjustments to the Defense Budget 34	
APPENDIXES		
A	CBO Baseline Budget Projections 37	
B	Major Contributors to the Revenue and Spending Projections 47	

TABLES

1.	CBO's Estimates of the President's Budgetary Proposals	2
2.	CBO's Estimates of the President's Budgetary Proposals Excluding Health	4
3.	CBO's Reestimates of the President's Budgetary Proposals Excluding Health	6
4.	The Administration's Proposals for Discretionary Spending in Fiscal Year 1995	10
5.	Estimates of Changes in the President's Budgetary Proposals for Mandatory Spending and Offsetting Receipts	12
6.	Estimated On-Budget and Social Security Effects of the Administration's Health Proposal	16
7.	Comparison of Congressional Budget Office, Administration, and <i>Blue Chip</i> Short-Run Economic Forecasts, Calendar Years 1992-1995	20
8.	Comparison of Federal Reserve, Congressional Budget Office, and Administration Economic Projections for 1994	21
9.	Comparison of Congressional Budget Office, Administration, and <i>Blue Chip</i> Economic Projections, Calendar Years 1993-1999	22
10.	Growth in Labor Productivity in the Nonfarm Business Sector	27
11.	Effects of CBO's Economic Projections on Estimates of the Administration's Budget	28
12.	The President's Budget for National Defense for the 1995-1999 Period as Estimated by CBO	30

13.	Estimated increases in the GDP Deflator	32
14.	Estimated Pay Raises for Military and Civilian Employees	33
A-1.	Changes in CBO Baseline Deficit Projections	38
A-2.	CBO Baseline Deficit Projections	39
A-3.	CBO Baseline Budget Projections, Assuming Compliance with Discretionary Spending Caps	40
A-4.	CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance	43
A-5.	How Tight Are the Discretionary Caps?	44
A-6.	The Budget Outlook Through 2004	45

FIGURES

1.	Comparison of Congressional Budget Office and Administration Economic Assumptions	25
2.	Quarterly Real Short-Term Interest Rates	26

BOXES

1.	Budget Enforcement Act Scorekeeping Rule 3	7
2.	The President's Proposals for Civilian Personnel	8

The President's Budgetary Proposals

The budget for fiscal year 1995 submitted by President Clinton carries on the fiscal policy established last August by the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). The Congressional Budget Office (CBO) projects that under current policies--which have changed little since last August--the deficit will be about \$180 billion in fiscal years 1995 and 1996 and gradually grow to \$213 billion in 1999. Adopting the Administration's budgetary proposals (excluding its health proposal) would not substantially affect anticipated deficits. CBO estimates that, in general, deficits under the policies set forth in the budget that the President submitted to the Congress would be slightly lower than those in CBO's current policy baseline; the largest reduction, in 1999, would be less than \$7 billion. Total outlays (excluding deposit insurance) in the President's budget would grow at a rate of less than 4 percent in 1995--the third year in a row that outlays have increased by less than 5 percent. In the previous 10 years, outlays grew at an average annual rate exceeding 6 percent. The relatively slow rate of growth in total outlays in 1995 is in large part the result of continued restraint of discretionary spending--total discretionary outlays will increase by less than 0.5 percent in 1995.

Overall, CBO's estimates of deficits under the policies reflected in the President's budget are little different from the Administration's: they are lower by \$7 billion in 1994 and higher by less than \$10 billion a year in 1995 through 1999.

Deficit Projections

CBO projects that under current policies the deficit will decline from \$228 billion in fiscal year 1994 to

\$180 billion in 1995 and 1996 before climbing to \$213 billion in 1999 (see Table 1). These baseline projections assume that discretionary spending will not exceed the limits in the Balanced Budget and Emergency Deficit Control Act of 1985 (Balanced Budget Act) for fiscal years 1995 through 1998 and will grow at the same rate as inflation in 1999. They also assume no change in current policies affecting mandatory spending or revenues. The current projections reflect small increases in deficits from the baseline projections released in January 1994 in CBO's *The Economic and Budget Outlook: Fiscal Years 1995-1999*. Those changes include the effects of legislation enacted on February 12, 1994, to provide relief for victims of the California earthquake (the Emergency Supplemental Appropriations Act of 1994, P.L. 103-211) as well as revisions resulting from new information. (The current projections and changes from the January baseline are detailed in Appendix A.)

CBO estimates that if the policies proposed by the Administration were adopted (other than the Administration's proposal to reform the nation's health care system), they would result in deficits little different from CBO's revised baseline deficits. (The Administration's health proposal is discussed later in this chapter.) This outcome is hardly surprising because the President's budget was intended to comply with the discretionary spending limits of the Balanced Budget Act and, except for the provisions included in the health proposal, the budget proposes only a few relatively minor changes in laws affecting mandatory spending or revenues.

Under the Administration's policies, CBO estimates that the deficit would be lower than the current baseline projection in 1994, 1996, 1997, and 1999 and higher than the baseline in 1995 and 1998. In only one year would the difference exceed \$5 billion--in 1999, when the deficit would be re-

duced by nearly \$7 billion below the baseline level. The reduction in 1999 is the result of continued restraint in discretionary spending in the President's budget in that year compared with CBO's baseline

assumption that discretionary outlays will grow at the rate of inflation after the discretionary caps expire at the end of 1998.

Table 1.
CBO's Estimates of the President's Budgetary Proposals (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
April Baseline Deficit Projections ^a	227.8	179.5	179.9	191.6	187.2	212.7
President's Budgetary Proposals Excluding Health						
Outlays						
Discretionary ^b	0	3.1	-5.1	-3.5	0.8	-11.0
Federal employee retirement offsets	0	0.5	1.1	1.6	2.1	2.6
Other mandatory and offsetting receipts	-0.4	-0.2	0.7	0.7	1.0	1.6
Net interest	<u>c</u>	<u>0.1</u>	<u>0.1</u>	<u>c</u>	<u>0.1</u>	<u>c</u>
Total	-0.4	3.5	-3.3	-1.2	4.0	-6.8
Revenues ^d	0	-0.5	c	0.1	0.3	0.3
Total Deficit Effect ^b	-0.4	3.0	-3.3	-1.2	4.3	-6.5
Deficits Under the President's Budgetary Proposals as Estimated by CBO and Excluding Health ^b	227.4	182.5	176.6	190.4	191.5	206.2
Administration's Health Proposal						
Deficit effect	0	-10.2	1.2	19.5	32.0	21.5
Debt service	<u>0</u>	<u>-0.3</u>	<u>-0.5</u>	<u>c</u>	<u>1.5</u>	<u>3.1</u>
Total	0	-10.5	0.7	19.5	33.5	24.6
Deficits Under the President's Budgetary Proposals as Estimated by CBO and Including Health	227.4	172.0	177.2	209.9	225.0	230.7

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

a. Assumes compliance with the discretionary spending limits of the Balanced Budget and Emergency Deficit Control Act of 1985.

b. Adjusted to reflect enacted supplemental appropriations and rescissions in the Emergency Supplemental Appropriations Act of 1994 (P.L. 103-211).

c. Less than \$50 million.

d. Reductions in revenues are shown with a positive sign because they increase the deficit.

The health proposal that is part of the President's budget would have a more significant effect on federal spending and revenues than the other proposals in the budget. CBO estimates that enactment of the health proposal would reduce the deficit by \$10 billion in 1995, when proposed increases in tobacco taxes would have taken effect but not most spending increases. In subsequent years, the deficit would be higher because the additional spending required to carry out the proposal would exceed the revenues proposed to pay for it.

CBO's estimates of deficits, spending by category, and revenues under the President's budgetary proposals (excluding health) are shown in Table 2. As in the baseline, deficits decline to about \$180 billion before rising to more than \$200 billion in 1999. As a percentage of gross domestic product (GDP), deficits are stable at about 2.4 percent after 1995--down from 3.4 percent in 1994. Although revenues are more or less constant as a percentage of GDP throughout the 1994-1999 period, total outlays decline from 22.3 percent of GDP in 1994 to 21.4 percent in 1999. Mandatory spending grows relative to the economy during the period--from 12.1 percent of GDP to 12.8 percent--while discretionary spending declines. By 1999, total discretionary spending will equal just 6.5 percent of GDP--down from 8.2 percent in 1994 and from an average of about 10 percent during the 1980s. Defense discretionary spending under the President's budget will decline from 4.2 percent of GDP in 1994 to 3.0 percent in 1999. Domestic discretionary spending will fall from 3.7 percent to 3.2 percent.

CBO has adjusted its estimates of the President's budget to reflect enactment of the Emergency Supplemental Appropriations Act of 1994. That act included emergency supplemental funding for relief for victims of the California earthquake and other disasters that was not part of the President's budget. In addition, the legislation rescinded some funds previously appropriated for fiscal year 1994 and provided nonemergency supplemental appropriations. CBO's estimates of the President's budget include these enacted rescissions and supplementals (emergency and nonemergency) in place of those proposed in the President's budget. CBO's estimates also reflect previously appropriated contingent

funds released after the President's budget was completed (through February 18, 1994).

CBO's Reestimates of the President's Budget

CBO's estimates of the President's budget (excluding the Administration's health proposal) are not substantially different from the Administration's estimates (see Table 3 on page 6). Except for 1994, when CBO estimates that the deficit under the President's policies would be \$7 billion less than the Administration has calculated, CBO's projections of the deficit are slightly higher than those of the Administration. The reestimates of the budget are small by historical standards, although the total CBO deficit reestimate is slightly larger than last year's, when the Administration adopted CBO's economic assumptions as the basis for preparing the President's budget. The Administration's economic assumptions this year are, for the most part, similar to CBO's, but the Administration's assumptions of lower interest rates in most years and higher inflation tend to reduce its estimates of the deficit (see Chapter 2). These reductions are offset to a large extent by CBO's more optimistic technical estimating assumptions.

Under CBO's assumptions, discretionary outlays would be higher than the Administration's estimates in the 1995-1999 period but lower in 1994. Part of the difference between the two sets of estimates is due to enactment of the Emergency Supplemental Appropriations Act of 1994, which was not reflected in the President's budget or the Administration's estimates but is included in CBO's reestimate. Total outlays from mandatory spending and offsetting receipts, according to CBO, would be lower in every year but 1997, because CBO's lower baseline spending--in part the result of its lower inflation forecast--generally offsets its estimate that legislation proposed in the President's budget would increase spending rather than reduce it, as the Administration asserts. For the first time in several years, the differences between CBO's and the Administration's estimates of spending for deposit insurance are not counted in double-digit billions, reflecting the improved health of financial institutions, reduced demands for federal funds to merge or close

insolvent institutions, and the diminished volatility of net spending. CBO estimates that spending for net interest will be substantially higher than the Administration projects because CBO forecasts higher interest rates than the Administration.

CBO's estimates of revenues under the President's policies (which differ only slightly from current law) are similar to the Administration's estimates. CBO's forecast of lower inflation reduces anticipated revenues, but this reduction is

Table 2.
CBO's Estimates of the President's Budgetary Proposals Excluding Health (By fiscal year)

	1994	1995	1996	1997	1998	1999
In Billions of Dollars						
Revenues						
Individual income	547	596	635	667	707	747
Corporate income	128	130	133	138	144	148
Social insurance	468	499	526	551	578	604
Other	<u>107</u>	<u>113</u>	<u>118</u>	<u>122</u>	<u>127</u>	<u>131</u>
Total	1,251	1,339	1,411	1,479	1,556	1,630
On-budget	910	978	1,031	1,080	1,136	1,190
Off-budget	341	360	380	399	419	440
Outlays						
Discretionary						
Defense	280	272	262	257	257	258
International	21	21	21	21	21	21
Domestic	<u>246</u>	<u>257</u>	<u>263</u>	<u>268</u>	<u>272</u>	<u>277</u>
Subtotal	547	549	546	545	550	555
Mandatory	801	847	898	964	1,030	1,102
Deposit insurance	-3	-12	-14	-6	-5	-4
Net interest	201	214	230	241	252	264
Offsetting receipts	<u>-68</u>	<u>-77</u>	<u>-72</u>	<u>-75</u>	<u>-80</u>	<u>-82</u>
Total	1,478	1,521	1,587	1,669	1,747	1,836
On-budget	1,198	1,231	1,284	1,354	1,420	1,497
Off-budget	280	291	303	315	327	339
Deficit	227	182	177	190	192	206
On-budget deficit	288	252	253	275	284	307
Off-budget surplus	60	70	76	84	92	100
Debt Held by the Public	3,464	3,653	3,840	4,044	4,251	4,473
Memorandum:						
Gross Domestic Product	6,637	7,006	7,386	7,780	8,185	8,597

(Continued)

offset in most years by assumed higher effective income tax rates that increase the estimates. Reestimates of the relatively minor revenue proposals included in the budget (excluding revenue provisions included in the Administration's health proposal) are quite small.

Discretionary Spending

Total discretionary budget authority proposed in the President's budget (adjusted for the enacted supple-

Table 2.
Continued

	1994	1995	1996	1997	1998	1999
As a Percentage of GDP						
Revenues						
Individual income	8.2	8.5	8.6	8.6	8.6	8.7
Corporate income	1.9	1.9	1.8	1.8	1.8	1.7
Social insurance	7.1	7.1	7.1	7.1	7.1	7.0
Other	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>
Total	18.8	19.1	19.1	19.0	19.0	19.0
On-budget	13.7	14.0	14.0	13.9	13.9	13.8
Off-budget	5.1	5.1	5.1	5.1	5.1	5.1
Outlays						
Discretionary						
Defense	4.2	3.9	3.5	3.3	3.1	3.0
International	0.3	0.3	0.3	0.3	0.3	0.2
Domestic	<u>3.7</u>	<u>3.7</u>	<u>3.6</u>	<u>3.4</u>	<u>3.3</u>	<u>3.2</u>
Subtotal	8.2	7.8	7.4	7.0	6.7	6.5
Mandatory	12.1	12.1	12.2	12.4	12.6	12.8
Deposit insurance	-0.1	-0.2	-0.2	-0.1	-0.1	a
Net interest	3.0	3.0	3.1	3.1	3.1	3.1
Offsetting receipts	<u>-1.0</u>	<u>-1.1</u>	<u>-1.0</u>	<u>-1.0</u>	<u>-1.0</u>	<u>-1.0</u>
Total	22.3	21.7	21.5	21.5	21.3	21.4
On-budget	18.0	17.6	17.4	17.4	17.3	17.4
Off-budget	4.2	4.1	4.1	4.0	4.0	3.9
Deficit	3.4	2.6	2.4	2.4	2.3	2.4
On-budget deficit	4.3	3.6	3.4	3.5	3.5	3.6
Off-budget surplus	0.9	1.0	1.0	1.1	1.1	1.2
Debt Held by the Public	55.1	52.1	52.0	52.0	51.9	52.0

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent.

Table 3.
CBO's Reestimates of the President's Budgetary Proposals Excluding Health
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
Deficits Under the President's Budgetary Proposals as Estimated by the Administration	234.8	176.1	173.1	180.8	187.4	201.2
Reestimates of Outlays						
Discretionary outlays						
Supplemental estimates	1.5	4.7	2.5	0.8	0.5	0.7
Other proposals	<u>-4.8</u>	<u>2.1</u>	<u>-0.9</u>	<u>0.2</u>	<u>1.6</u>	<u>0.3</u>
Subtotal, Discretionary Outlays	-3.3	6.8	1.6	0.9	2.1	1.0
Mandatory outlays and offsetting receipts						
Baseline						
Economic differences	-0.7	-0.8	-1.5	-3.2	-3.8	-5.6
Technical differences	<u>0.1</u>	<u>-3.2</u>	<u>a</u>	<u>3.0</u>	<u>1.8</u>	<u>-0.9</u>
Subtotal	-0.6	-4.1	-1.5	-0.2	-2.0	-6.5
Proposed legislation	<u>0.2</u>	<u>0.6</u>	<u>1.3</u>	<u>1.3</u>	<u>1.8</u>	<u>2.8</u>
Subtotal, Mandatory Outlays and Offsetting Receipts	-0.4	-3.5	-0.2	1.2	-0.2	-3.7
Deposit insurance	-0.1	-1.0	-2.8	0.1	0.1	-0.3
Net interest						
Economic differences	-1.0	1.0	6.5	8.6	11.0	15.2
Technical differences	<u>-1.3</u>	<u>-0.5</u>	<u>-1.4</u>	<u>-2.0</u>	<u>-4.0</u>	<u>-6.5</u>
Subtotal, Net Interest	-2.3	0.5	5.2	6.6	7.0	8.7
Total, Outlays	-6.1	2.9	3.8	8.8	9.0	5.7
Reestimates of Revenues ^b						
Baseline						
Economic differences	-0.6	1.0	5.0	12.0	21.8	33.8
Technical differences	<u>-0.8</u>	<u>2.4</u>	<u>-5.3</u>	<u>-11.2</u>	<u>-26.7</u>	<u>-34.5</u>
Subtotal	-1.4	3.4	-0.3	0.9	-4.9	-0.7
Proposed legislation	<u>a</u>	<u>a</u>	<u>a</u>	<u>-0.1</u>	<u>a</u>	<u>0.1</u>
Total, Revenues	-1.3	3.4	-0.3	0.8	-4.8	-0.7
Total Deficit Reestimates	-7.4	6.4	3.5	9.6	4.1	5.0
Deficits Under the President's Budgetary Proposals as Estimated by CBO	227.4	182.5	176.6	190.4	191.5	206.2
Memorandum:						
Total Economic Differences	-2.3	1.2	10.1	17.5	29.0	43.4
Total Technical Differences	-5.1	5.1	-6.6	-7.9	-24.9	-38.4

SOURCE: Congressional Budget Office.

a. Less than \$50 million.

b. Reductions in revenues are shown with a positive sign because they increase the deficit.

mental appropriation bill) would be well below CBO's capped baseline in every year through 1999. CBO's analysis indicates that discretionary outlays would also be below the baseline in 1996, 1997, and 1999 but would be above it in 1995 and 1998. Because baseline discretionary spending is equal to CBO's estimated end-of-session spending limits for each year under the Balanced Budget and Emergency Deficit Control Act, the outlay cap would be exceeded in 1995 and 1998 according to CBO's estimates. The Administration has calculated that 1995 discretionary outlays in the President's budget would be almost exactly equal to the spending limit (a scant \$10 million below), but CBO estimates that spending would exceed the cap by \$3.1 billion.

Estimating Differences for Discretionary Outlays for 1995

There are three reasons for the difference between the Administration's and CBO's estimates of total outlays for discretionary programs in 1995. First,

CBO estimated that outlays from discretionary proposals in the budget other than proposed supplementals or rescissions of 1994 budget authority would be \$2.1 billion higher than the Administration had calculated. About one-third of this difference lies in estimates of the General Services Administration's Federal Buildings Fund and another account related to facilities for federal agencies; the rest is the result of smaller reestimates in numerous programs.

Second, the Administration calculated that together the rescissions and nonemergency supplemental appropriations proposed in the President's budget would cut discretionary outlays by more than \$1.2 billion. The Congressional Budget Office, however, estimated that the net reduction in outlays resulting from the rescissions and nonemergency supplementals actually enacted in the Emergency Supplemental Appropriations Act was less than \$0.8 billion--almost \$0.5 billion less than the reduction that the President's budget assumed.

Box 1.

Budget Enforcement Act Scorekeeping Rule 3

The Budget Enforcement Act of 1990 (BEA) amended the Balanced Budget and Emergency Deficit Control Act of 1985 to establish new controls on spending and revenue legislation. It instituted two separate systems of control--one for discretionary spending and another for mandatory spending and revenues. Under the procedures established by the BEA, discretionary spending is limited by annual caps on budget authority and outlays. If enacted discretionary appropriations for any year exceed either cap, an across-the-board cut of those appropriations lowers discretionary spending to the cap level. Mandatory spending and revenues are controlled by pay-as-you-go (PAYGO) procedures. Under the PAYGO procedures, the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) track all mandatory spending or revenue legislation enacted since the BEA. If all such legislation together has the effect of increasing the deficit, spending for nonexempt mandatory programs is cut by the amount of the deficit increase.

Despite the separate control mechanisms, changes in mandatory spending can affect the enforcement of

the discretionary limits, and appropriations for discretionary accounts can enter into the PAYGO calculations. The statement of managers accompanying the conference report on the BEA (House Report 101-964) contains a set of scorekeeping rules to guide OMB, CBO, and the House and Senate Budget Committees in carrying out the BEA procedures. Scorekeeping rule 3--the so-called fingerprint rule--states that substantive changes in mandatory spending made in appropriation bills will be scored as discretionary. This rule is intended to assign responsibility for any BEA violation to those who caused the violation. Following the lead of OMB and the House and Senate Budget Committees, CBO has complied with scorekeeping rule 3 and an extension of the rule that holds that an appropriation for a discretionary account provided in an authorizing bill should be included on the PAYGO scorecard. Because the legislative language of the BEA clearly puts all changes in revenues on the PAYGO side of the ledger, CBO does not believe that the scorekeeping rule can be further extended to allow increases in revenues provided in appropriation bills to be counted as offsets to discretionary spending.

Finally, the Administration assumed that \$0.5 billion in new revenues would be generated by new or increased fees to be enacted in appropriation acts and that those revenues would be counted as offsets to discretionary spending for purposes of complying with the spending limits. CBO believes that the Balanced Budget Act does not allow revenue in-

creases to be counted as offsets to discretionary spending in determining compliance with the caps, even if the revenue increases are the result of provisions contained in appropriation acts (see Box 1 on page 7). CBO includes the effect of these proposed changes in its estimate of revenues under the President's budgetary proposals.

Box 2.

The President's Proposals for Civilian Personnel

President Clinton's budget limits the growth of federal civilian payrolls on two fronts: by reducing the number of civil servants and by curtailing the pay raises that they would receive. Because neither aspect of this two-pronged plan is fully spelled out in the President's budgetary proposals, no precise budgetary effects can be attached. Nevertheless, the plan's broad shape is clear.

The Administration estimates that full-time-equivalent (FTE) employment in the executive branch of government will be 2.084 million in fiscal year 1994, down from 2.134 million in 1993.¹ (These totals exclude employees of the Postal Service and the legislative and judicial branches.) The Administration wants to trim FTE employment to 2.037 million in 1995 and to 1.903 million in 1999. Attaining this last goal would enable the Administration to claim that it had met the National Performance Review's goal of cutting federal employment by 252,000, measured against a base (roughly, the number of people that the new Administration thought could have been employed in 1993) of 2.155 million.

Not surprisingly, many of the reductions in employment would occur in the Department of Defense. Between 1994 and 1999, the number of civilian employees of the Pentagon would drop by about 120,000, or 14 percent (continuing a trend that began around 1990), and the number of employees of other agencies would fall by about 60,000, or about 5 percent.

Recently enacted legislation requires somewhat steeper reductions in the executive branch work

force than were assumed in the President's budget. The Federal Workforce Restructuring Act of 1994 (P.L. 103-226), signed on March 30, limits FTE employment in 1999 to 1.882 million, about 20,000 less than the Administration had assumed. That legislation will also help agencies to achieve the required reductions by permitting them to offer the lower of \$25,000 or normal severance pay to employees who resign or retire—an approach that is widely viewed as not just more humane but more efficient than a reduction in force.² The Defense Department has had similar authority since 1993.

The President's budget for 1995 also assumes pay raises that are less than half as generous as those that would be payable under current law. Current law provides for two types of raises for civil servants: an across-the-board raise tracking the national increase in the employment cost index minus one-half of a percentage point, plus a locality increase, which varies by area and is designed to gradually narrow estimated gaps between federal and nonfederal pay scales. The initial round of local salary surveys found that, on average, federal salaries lagged 26 percent behind those for comparable jobs in the private sector. CBO estimates that across-the-board pay raises in 1995 through 1999 under current law would average about 2.9 percent and locality increases about 2.3 percent, for a combined raise of more than 5 percent. The President's budget assumes a total increase of 1.6 percent in 1995 and average increases of 2.4 percent in 1996 through 1999. The Administration is silent about whether these increases would be paid across the board or whether they would differ by locality. It has promised to consult with the Congress on this matter.

1. The FTE concept automatically adjusts for the presence of part-time or seasonal workers and is thus a better way to measure employment than a simple head count or "snapshot."

2. Congressional Budget Office, *Reducing the Size of the Federal Civilian Work Force* (December 1993).

Proposed Discretionary Spending Compared with CBO's Uncapped Baseline

Compliance (or near compliance) with the discretionary spending limits of the Balanced Budget Act in 1995 through 1998 requires a substantial reduction in appropriations below CBO's uncapped baseline--the amount needed, after adjusting for inflation, to maintain the level of funding enacted for 1994 (excluding emergency funding, which is assumed to meet one-time needs). CBO estimates that the President's budgetary proposals for discretionary spending (excluding the Administration's health proposal) would total \$162 billion in budget authority below the uncapped baseline amounts for the 1995-1999 period. Reductions that the President's budget specifies in discretionary funding for defense account for \$136 billion of this amount. (See Chapter 3 for a discussion of the President's proposals for defense spending.)

An additional \$15 billion in cuts is included in the Allowances section of the budget; these cuts represent reductions--such as assumed savings from reforming procurement practices--that were not assigned to specific accounts. According to budget amendments submitted by the Administration, some of these savings are proposed for the Department of Defense and other agencies that administer defense spending--implying that there should be cuts in defense as well as nondefense accounts to achieve the assumed savings (see Chapter 3). The remaining reductions are widely distributed among non-defense programs. Because the great bulk of expenditures for federal personnel are discretionary, the Administration's plans to reduce the number of executive branch employees and constrain pay raises over the next five years will help achieve the proposed reductions in discretionary spending (see Box 2). If the savings from trimming personnel are less than the Administration assumes and discretionary spending is not increased, less funding will be available for nonpersonnel purposes.

In 1995, the budget proposes total discretionary budget authority that is \$4.0 billion below the uncapped baseline and \$12.9 billion above the amount needed to freeze funding at the 1994 level without adjusting for inflation. Proposed cuts in defense

below the uncapped baseline equal \$5.2 billion plus the portion of the \$1.2 billion in cuts carried in the Allowances section that is ultimately applied to defense programs. The President's budget for international programs essentially equals the uncapped baseline; the budget proposes a real increase--above the uncapped baseline--for domestic discretionary programs. The proposed increase in domestic funding totals \$1.1 billion if all of the reductions carried in the Allowances function are assumed to come from domestic accounts; it is larger to the extent those savings come from defense spending. Table 4 shows the level of discretionary spending for fiscal year 1995 proposed in the budget for each functional category compared with CBO's uncapped baseline for the function. For this table the baseline has been adjusted to remove from each function any projected 1995 funding that resulted from extrapolating 1994 emergency appropriations.

As Table 4 indicates, the aggregate increase in budget authority for domestic discretionary programs is not equally distributed. Funding for a number of budget functions and programs is cut below the baseline to allow increases for others. For instance, proposed funding for the General Science, Space, and Technology function is nearly 5 percent below the baseline, largely as a result of cuts in the Department of Energy's general science and research activities and reductions in funding for the National Aeronautics and Space Administration. The Natural Resources and Environment function is also cut about 5 percent below the baseline, with reductions in funding for water resources activities of the Department of Agriculture and the Army Corps of Engineers and land management and conservation programs of the Forest Service and other agencies. Funding cuts for other functions are smaller in percentage terms.

The largest increase in 1995 funding above the baseline--16 percent--is for the Administration of Justice function. This expansion reflects funding for the President's proposed crime bill, including an increase of more than \$2 billion for criminal justice assistance to state and local governments. The budget also boosts funding for salaries and expenses related to the operation of Federal courts and prisons, but this is partially offset by reduced funding for prison construction and federal law enforcement

activities. The President's budget proposes to raise the level of funding for Community and Regional Development by nearly 10 percent, almost entirely the result of \$800 million for new project-based community development grants. The increase for Education, Training, Employment, and Social Services is smaller as a percentage of baseline funding--about 7 percent--but represents the largest

increase in dollars. The \$2.9 billion increase includes \$683 million in additional funding for the Summer Youth and Dislocated Worker programs, \$230 million more for the National Service program, and \$558 million more for Children and Family Services--primarily for the Head Start program. The President's budget also proposes to expand funding for the General Government func-

Table 4.
The Administration's Proposals for Discretionary Spending in Fiscal Year 1995
(In billions of dollars)

Category	CBO Baseline Without Discretionary Caps ^a		President's Budget as Estimated by CBO		President's Budget Minus CBO Baseline	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Defense	269.5	273.2	264.3	271.7	-5.2	-1.5
International	20.9	20.9	20.9	20.9	b	b
Domestic						
General science, space, and technology	18.1	17.8	17.3	17.2	-0.8	-0.6
Energy	6.6	6.4	6.4	6.5	-0.2	0.1
Natural resources and environment	22.4	22.0	21.4	21.4	-1.1	-0.6
Agriculture	4.5	4.5	4.2	4.3	-0.3	-0.2
Commerce and housing credit	3.5	3.3	3.7	3.5	0.2	0.2
Transportation	15.4	39.7	15.4	39.2	b	-0.5
Community and regional development	8.4	12.0	9.2	12.1	0.8	b
Education, training, employment, and social services	41.2	39.9	44.1	40.5	2.9	0.7
Health	22.8	22.4	22.4	22.0	-0.4	-0.4
Medicare	3.1	3.1	3.0	3.0	-0.1	-0.1
Income security	34.4	38.2	32.8	37.1	-1.6	-1.1
Social Security	0	2.9	0	2.6	0	-0.4
Veterans' benefits	18.5	18.4	17.9	17.7	-0.5	-0.7
Administration of justice	15.7	15.9	18.3	17.0	2.6	1.1
General government	12.7	13.1	13.5	13.5	0.8	0.4
Allowances	0	0	-1.2	-1.0	-1.2	-1.0
Subtotal, Domestic ^c	227.3	259.7	228.4	256.6	1.1	-3.1
Total, Discretionary Spending	517.7	553.8	513.6	549.2	-4.0	-4.6

SOURCE: Congressional Budget Office.

- a. Adjusted to remove from each function any 1995 funding that results from extrapolating 1994 emergency appropriations.
- b. Less than \$50 million.
- c. Includes all proposed reductions carried in function 920 in the President's budget.

tion by 7 percent in order to provide additional funds for construction and acquisition of new federal buildings to replace space that is currently being leased.

In general, CBO's estimate of discretionary outlays in the President's budget represents spending that will occur if the budget authority requested for each discretionary account is appropriated, rather than the effects of carrying out discretionary program policies that may be described in the budget. For instance, the budget proposes to reduce discretionary budget authority by more than \$12 billion over the 1995-1999 period as a result of savings that the Administration asserts can be achieved by reforming federal procurement practices. The budget carries these reductions as a lump sum in the Allowances function, but the Administration has provided the Congress with amended budget requests indicating how these reductions should be distributed by agency. CBO's analysis of reform legislation proposed last year (S. 1587) suggests that savings from reforming procurement are highly uncertain. However, CBO gives full credit for the claimed savings in its estimate of the budget because the budget proposes that appropriations be reduced by a specified amount, regardless of the amount actually saved by reforming procurement practices. Thus, even if reform fails to reduce the costs of purchasing the level of goods assumed in the budget by as much as the Administration believes it will, savings will still be achieved because the lower level of appropriations will force a reduction in the amount of goods purchased.

Nondiscretionary Spending

Aside from the Administration's health proposal, the President's 1995 budget proposes relatively few changes in law affecting spending that is not controlled by annual appropriation action. This category comprises mandatory spending (including spending for deposit insurance), offsetting receipts, and net interest payments. CBO estimates that the President's budgetary proposals would increase nondiscretionary spending (other than net interest) by more than \$11 billion above the CBO baseline over the 1994-1999 period.

Proposed Nondiscretionary Spending Compared with CBO's Baseline

The biggest change in this category triggered by the President's budgetary proposals--the loss of almost \$8 billion in receipts of federal employee retirement trust funds--comes from proposed changes in discretionary spending rather than amendments to current law governing those receipts. Under current law, agencies must contribute a specified percentage of each employee's salary to the retirement trust funds. Because the payments are generally made out of salary and expense accounts that are annually appropriated, they are largely categorized as discretionary spending. The offsetting receipts deposited in the trust funds are counted as mandatory negative budget authority and outlays.

The President's budget proposes to reduce the number of federal civilian employees below this year's level over the next five years and to hold pay raises for employees below the rates required under current law (see Box 2 on page 8). Both of these actions will reduce total employee salaries and correspondingly lower payments to the retirement trust funds. The reduction in contributions to the trust funds helps the Administration hold down total discretionary spending, but it also shows up on the mandatory side of the budget as a loss of offsetting receipts, which is equivalent to an increase in mandatory spending. (Of course, trimming the federal work force also reduces the long-term liabilities of the trust funds, which will show up as lower outlays sometime after 1999.)

Other proposals affecting mandatory programs and offsetting receipts reduce spending slightly in 1994 and 1995 while increasing outlays by more than \$3 billion over the entire 1994-1999 period (see Table 5). A proposal to expand the crop insurance program to provide additional assistance to farmers who suffer crop losses as a result of natural disasters--forgoing the current practice of providing assistance through ad hoc emergency legislation to deal with a specific disaster--produces the largest increase in mandatory spending, about \$1 billion a year by 1998. Other major proposals include new mandatory spending from the Nuclear Waste Fund that totals \$1.0 billion over five years, changes in Pension Benefit Guaranty Corporation premiums

and funding requirements that would save \$1.7 billion in 1995 through 1999, and a new program to subsidize U.S.-flag cargo vessels that would cost \$0.5 billion over five years but would be offset by an increase of \$0.1 billion a year in tonnage fees. The budget also proposes asset sales--of the Alaska Power Administration and of rights to produce Naval Petroleum Reserve oil--that would produce offsetting receipts of \$1.4 billion over five years. The proceeds from the asset sales would be offset,

however, by an approximately equal amount of lost income that would have been generated by these assets.

The President's budget does not include any proposals relating to welfare reform or the General Agreement on Tariffs and Trade (GATT). The costs of welfare reform are uncertain because the Administration's plan is still being developed. Based on preliminary information, the implementa-

Table 5.
Estimates of Changes in the President's Budgetary Proposals for
Mandatory Spending and Offsetting Receipts (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
New Farm Disaster Relief Program	0	0.3	0.8	0.9	1.0	1.1
Pension Benefit Guaranty Corporation Reforms	0	-0.1	-0.3	-0.5	-0.5	-0.5
Nuclear Waste Fund	0	a	0.2	0.2	0.3	0.3
Maritime Administration Operating Differential Subsidy	0	0.1	0.1	0.1	0.1	0.1
Tonnage Fees	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Hardrock Mineral Royalties	0	0	a	-0.1	-0.1	-0.1
Extend Family Preservation and Support	0	0	0	0	0	0.2
Multifamily Property Disposition	-0.4	0	0	0	0	0
Asset Sales	0	-0.4	-0.3	-0.3	-0.3	a
Forgone Receipts from Asset Sales	0	0	0.4	0.4	0.4	0.3
Other	<u>0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>a</u>	<u>0.1</u>	<u>0.2</u>
Total	-0.4	-0.2	0.7	0.7	1.0	1.6

SOURCE: Congressional Budget Office.

NOTE: The figures in the table exclude the effects of the Administration's health proposal and federal employee retirement offsets.

a. Less than \$50 million.

tion of GATT is likely to reduce revenues by roughly \$13 billion over five years, which under pay-as-you-go rules must be offset by enacting spending reductions or increases in other revenues before the final sequestration report for each affected year.

CBO's Reestimates of Nondiscretionary Spending

CBO's estimates of the effects of proposed changes to mandatory programs and offsetting receipts in the President's budget over the 1994-1999 period are \$8 billion higher than the Administration's estimates. The most expensive proposal--the new farm disaster assistance program--was also subject to the largest CBO reestimate. CBO estimated somewhat higher spending for the proposed new program than did the Administration in every year except 1999. But the major part of the difference arose because the Administration counted savings of \$0.5 billion in 1995 and \$1.0 billion a year in 1996 through 1999 from repeal of the Secretary of Agriculture's current authority to provide disaster relief to some farmers. Because this authority has never been used, CBO does not include any spending under it in the baseline and does not count any savings from its repeal. As a result, CBO estimates that the new policy will increase spending by more than \$4.1 billion over five years. In contrast, the Administration estimates net savings of more than \$0.6 billion.

Another substantial reestimate involves the savings in the U.S. Enrichment Corporation Fund. The Administration estimates that proposed reforms will produce savings of \$1.1 billion over five years. CBO estimates that the proposals will generate no savings. Other reestimates of proposed policies produced smaller differences than this one and the difference in the estimates for farm disaster assistance.

CBO's estimate of total outlays for mandatory programs and offsetting receipts under current law is below the Administration's estimate by a total of \$14.8 billion over the 1994-1999 period. A significant portion of this net reestimate stems from the \$4.5 billion in spending for emergency farm disaster assistance that the Administration built into its base-

line; the CBO baseline, in contrast, assumes no outlays for the disaster assistance that would be allowed under current law. CBO estimates that Medicare spending under current law during this period would be \$6.7 billion higher than the Administration expects but that Medicaid spending would be \$4.3 billion less than the Administration anticipates. CBO's current-law estimate of the cost of benefits in a number of programs such as Food Stamps, Supplemental Security Income, and civil service and military retirement is \$12.1 billion lower than the Administration's. Almost half of that difference is the result of a lower inflation forecast; the rest stems from a variety of technical estimating differences. Lower inflation also pushes CBO's estimate of baseline Social Security spending below the Administration's by \$8.2 billion. That reduction is partially offset, however, by other factors that increase CBO's estimate by \$3.7 billion compared with that of the Administration--a small reestimate compared with total spending for Social Security.

CBO's baseline estimate of spending for veterans' programs is lower than the Administration's by \$9.0 billion, of which \$0.5 billion is the result of CBO's lower inflation assumption. The remaining difference is largely the result of CBO's assumption that the number of veterans receiving compensation and pension benefits is smaller and declining more rapidly than the Administration projects.

CBO's estimate of net spending for the Federal Housing Administration's mutual mortgage and cooperative housing insurance fund and other credit reform liquidating accounts related to housing is \$10 billion higher than the Administration's. Different assumptions about defaults, recoveries, debt redeemed, and a number of other factors that affect liquidating accounts are responsible for the difference between the two estimates.

CBO estimates that receipts from the Federal Communications Commission's auction of rights to part of the electromagnetic spectrum will be \$5 billion less than the Administration projects. Although there is a good deal of uncertainty about the exact amount that the auction will generate, CBO believes that competitive pressures are likely to hold

bids below the level that the Administration assumes. Other smaller reestimates--some higher, some lower--were also made by CBO.

Both CBO and the Administration estimate that aggregate collections by deposit insurance agencies (largely from premiums and the disposal of assets that those agencies hold) will exceed the spending needed to close additional insolvent institutions in every year through 1999. Compared with previous years, the difference between CBO's and the Administration's baseline estimates of net deposit insurance spending is small--CBO's estimate is \$4.0 billion lower over the 1994-1999 period. The President's budget did not include any proposals that would affect deposit insurance.

CBO's estimate of net interest under the policies of the President's budget is \$25.7 billion higher than the Administration's estimate over the 1994-1999 period. CBO's forecast that interest rates after 1994 will be higher than the Administration assumes pushes up projected net interest spending by \$33.7 billion. An additional \$7.7 billion reestimate of interest costs can be attributed to the increase in estimated deficits and borrowing that results from using CBO's economic assumptions. These reestimates are partially offset--CBO's interest projections are lowered by \$15.7 billion--by reestimates attributable to differences between CBO's and the Administration's assumptions and projection methods relating to intermediate-term securities and to reductions in estimated deficits and borrowing that result from using CBO's technical assumptions.

Revenues

CBO's estimate of revenues under the policies of the President's budget is quite similar to the Administration's. In total over the 1994-1999 period, CBO's estimate is only \$3 billion higher (see Table 3 on page 6). The proposals in the President's budget to change laws affecting revenues--other than the revenue provisions that are part of the health proposal--are quite minor. Adopting all of the proposals would change revenues by no more than \$0.5 billion in any year; the net change over the 1994-1999 period would be only \$0.1 billion. CBO's and the Administration's estimates of the total effect of the proposals differ by less than \$0.1 billion in each year.

CBO's baseline estimate of revenues under current law is also quite similar to the Administration's. The two estimates are within \$5 billion of each other in all years, and in three years the difference is less than \$1 billion. CBO's estimate for 1994 is \$1 billion higher than the Administration's, and its 1995 estimate is \$3 billion lower. Economic differences are small until 1996, but CBO's forecast of GDP is \$33 billion lower than the Administration's in fiscal year 1996, with the difference growing to \$154 billion in 1999 (see Chapter 2). If all other assumptions and projection techniques were the same, these differences in the economic forecast would cause CBO's revenue projections to be \$34 billion below the Administration's in 1999. But differences in the methods used to project income tax revenues lead to offsetting differences in the estimates. A variety of small technical differences combine to produce higher revenues from individual income taxes in CBO's projections than in the Administration's estimates for the same level of income. In addition, because CBO assumes that a larger share of the growth in profits accrues to taxpaying firms, it estimates higher revenues from corporate income taxes than does the Administration for the same level of income.

The Administration's Health Proposal

The President's budget submission for 1995 incorporates the Administration's proposal to create a universal entitlement to health insurance and to slow the rate of growth of spending for health care. This section summarizes the impact of the proposal on national health expenditures and the federal budget. A more detailed discussion can be found in CBO's *An Analysis of the Administration's Health Proposal* (February 1994), which also examines the proposal's budgetary treatment, its effect on the economy, and other considerations concerning its implementation. Because the Administration's proposal and many other health reform plans would not be fully implemented within the usual five-year estimating period, CBO has provided estimates through 2004. This longer time horizon and the sweeping nature of the proposed changes, however, necessarily make the estimates less precise than usual.

The Administration's health proposal would redesign the current system of financing for health care for people under age 65 while building on the system's existing employer base. All employers would be required to pay premiums on behalf of their employees, and all individuals and families--except people receiving Aid to Families with Dependent Children and Supplemental Security Income, and others with very low income--would be required to pay at least part of their premiums. Subsidies would be available to help employers and low-income families meet these obligations and would also be available to retired people ages 55 to 64.

To strengthen the demand side of the health care marketplace, the proposal would establish regional purchasing alliances through which most people under age 65 would obtain coverage for health care. Consumers would normally have access to a choice of health plans of different types--including at least one fee-for-service plan--that would be offered through the alliance in the area in which they lived. All plans would offer a standard package of benefits, which would be slightly more generous than the average plan currently offered by employers. To lower the rate of growth of health care spending, the proposal would establish a complex mechanism for limiting the growth of premiums for the standard benefit package.

The proposal would also expand several federal programs and institute new ones. Important among these provisions are coverage of prescription drugs for Medicare beneficiaries, the provision of wrap-around health care benefits for low-income children, and a new program to provide home- and community-based services for severely disabled people.

Financing for the premium subsidies and programmatic expansions would come from a variety of sources. They would include several new revenue measures, increases in income and payroll tax receipts generated by the change in the mix of employee compensation that would occur under the proposal, reductions in the costs of the Medicare and Medicaid programs, and assessments on premiums. States would also make maintenance-of-effort payments to alliances, reflecting their reduced obligations for Medicaid under the proposal.

Once the Administration's proposal was fully implemented, it would significantly reduce the projected growth of national health expenditures. Its provisions for covering the uninsured, providing better coverage for many people who already have insurance, and establishing a new federal program of home- and community-based care for the severely disabled would increase the demand for health care services. But the limits on the growth of health insurance premiums and the reductions in the Medicare program would hold down spending for health. For the first few years after the proposal was in place, the increases in spending would exceed the decreases, and the proposal would raise national health expenditures above the levels in the baseline. From 2000 on, however, national health expenditures would fall below the baseline by increasing amounts. By 2004, CBO projects that total spending for health would be \$150 billion--or 7 percent--below where it would be if current policies and trends continued. National health expenditures in 2004 would represent 19 percent of GDP--5 percentage points above the current level but more than a percentage point below the baseline.

The effects of the proposal on the federal budget deficit show a similar pattern (see Table 6). The increase in the deficit is estimated to reach slightly more than \$30 billion in 1998, the first year in which all states would be participating in the system, and then begin to fall. It would rise again because of increases in the generosity of the standard benefit package that would occur in 2001 and the extension of subsidies to state and local governments as employers in 2002. By 2004, however, the estimated effects on the deficit would be negligible.

In the President's 1995 budget, the Administration estimates that its health proposal would reduce the deficit by \$38 billion in 2000 and by \$59 billion cumulatively over the 1995-2000 period. (The Administration has not provided estimates for later years.) In contrast, CBO estimates that the proposal would increase the deficit by \$10 billion in 2000 and by a total of \$74 billion over the six-year period. The difference between these estimates is small, however, compared with the uncertainty surrounding the budget projections.

Table 6.
Estimated On-Budget and Social Security Effects of the Administration's Health Proposal
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Outlays									
Subsidy Payments									
Subsidies for employers	5	17	44	55	58	67	81	92	102
Subsidies for families	6	20	54	67	70	77	83	89	95
State maintenance-of-effort payments	-2	-6	-16	-20	-20	-21	-22	-23	-24
Subtotal	9	30	82	102	108	123	142	158	173
Medicare									
Drug benefit	6	15	16	17	19	21	23	25	28
Program savings	-7	-12	-19	-28	-37	-45	-54	-65	-77
Offset for employed beneficiaries	-1	-2	-6	-8	-8	-8	-9	-9	-10
Other changes	1	1	1	2	2	2	2	2	2
Subtotal	a	2	-8	-16	-24	-30	-38	-47	-57
Medicaid									
Discontinued coverage	-2	-7	-19	-27	-31	-34	-38	-43	-48
Premium limits and DSH cuts	-1	-5	-14	-20	-24	-28	-33	-39	-45
Other changes	1	2	4	1	1	1	1	1	1
Subtotal	-2	-10	-28	-46	-54	-62	-71	-81	-92
Long-Term Care Benefit	5	8	12	16	20	28	37	40	40
Supplemental Services for Children	a	1	2	2	2	2	3	3	3
Medical Education	1	3	4	6	6	6	7	7	7
Public Health Service	2	3	3	2	2	2	2	2	2
Department of Defense	-1	-2	-2	-3	-3	-3	-3	-3	-4
Department of Veterans Affairs	a	a	-4	-5	-5	-5	-5	-5	-5
Federal Employees Health Benefits	a	a	-3	-3	-4	-5	-6	-7	-8
WIC Program	a	1	1	1	1	1	1	1	1
Other Administrative and Start-Up Costs	1	2	1	1	1	1	1	1	1
Social Security Assessment for Medical Education	a	a	1	2	2	2	2	2	2
Education	-1	-2	-6	-8	-8	-9	-9	-10	-10
Total, Outlays	15	36	54	50	43	51	61	60	53

Table 6.
Continued

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Revenues									
Income and Payroll Taxes									
on Additional Income	a	1	4	8	12	16	22	28	34
Increase in the Excise Tax									
on Tobacco	11	11	11	11	10	10	10	10	10
Assessment on Corporate									
Alliance Employers	1	2	2	2	1	1	1	1	1
Extension of Medicare HI Tax	2	2	2	2	1	1	1	1	1
Exclusion of Health Insurance									
from Cafeteria Plans	0	1	2	3	4	5	6	7	7
Assessment on Employers									
for Retiree Subsidies	0	0	3	5	5	2	0	0	0
Deduction of Health Insurance									
for the Self-Employed	-1	-1	-2	-2	-2	-3	-3	-3	-3
Other Changes	<u>a</u>	<u>2</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>2</u>	<u>2</u>	<u>3</u>	<u>3</u>
Total, Revenues	14	17	22	29	33	35	40	46	53
Deficit									
Total Effect	1	20	32	21	10	16	22	14	a

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTES: DSH = disproportionate share hospitals; WIC = Special Supplemental Food Program for Women, Infants, and Children; HI = Hospital Insurance.

The Administration's proposal would reduce the deficit by \$10 billion in 1995.

The figures in the table include changes in authorizations of appropriations and in Social Security that would not be counted for pay-as-you-go scoring under the Budget Enforcement Act of 1990.

a. Less than \$500 million.

Comparison of Economic Forecasts

The economic forecasts of the Congressional Budget Office and the Clinton Administration for the 1993-1999 period are similar (see Tables 7 and 9). Moreover, with the exception of long-term interest rates, both forecasts resemble the consensus of private forecasters recently surveyed by the *Blue Chip Economic Indicators*.¹ The CBO and Administration forecasts differ slightly in their outlooks for inflation and interest rates, however. For both the short and medium terms, the CBO outlook indicates slightly higher interest rates and lower inflation. Although these differences appear to be minor, they have marked implications for the budget deficit projections. When CBO's economic assumptions are substituted for those of the Administration, the deficit projections are higher in every year except 1994 and amount to a cumulative difference of \$99 billion over the 1994-1999 projection period.

The Administration's economic forecast embodies the effects of the 1995 budget proposal (excluding health care reform), whereas CBO's forecast and medium-term assumptions are based upon current law. Because the proposed policy changes do not affect revenues and outlays significantly, however, the differences in the fiscal policy assumptions should not affect a comparison of the projections.

Short-Term Outlook

Both CBO and the Administration expect the U.S. economy to expand at an annual rate of nearly 3

percent (on a fourth-quarter-to-fourth-quarter basis) through 1995; both forecasts anticipate small declines in the unemployment rate and a rise in short-term interest rates.²

The most noticeable difference between CBO and Administration forecasts is in the outlook for short-term interest rates. CBO projections show slightly higher three-month Treasury bill rates over the 1994-1995 period. The forecast of a higher interest rate, in combination with the projections of steady inflation by CBO and the Administration, indicate that real (inflation-adjusted) interest rates are expected to rise. CBO's rationale for this rise in real rates is based on the current policy objectives of the Federal Reserve and future conditions in the capital market. To dampen future inflationary pressures, policymakers will probably allow short-term real rates to rise as the economy continues to grow. Moreover, CBO expects that there will be some upward pressure on real interest rates in the capital market because the supply of domestic savings will be more than offset by higher federal borrowing and an increase in the demand for capital, both domestic and foreign.

Since the forecast was made, economic data have shown an unexpectedly strong growth in real gross domestic product of 7.0 percent in the fourth quarter of 1993. The unusually high growth rate at

1. Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (April 10, 1994).

2. The Bureau of Labor Statistics changed the way it conducts the unemployment survey as of January 1994 [see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1995-1999* (January 1994), p. 9]. The change raises the level of the unemployment rate by about 0.4 percentage points. The new measure is used here for the forecast years; the CBO and Administration forecasts, which were based on the previous methodology, have been adjusted upward by 0.4 percentage points in an attempt to make them comparable with recently released data.

Table 7.
Comparison of Congressional Budget Office, Administration, and
Blue Chip Short-Run Economic Forecasts, Calendar Years 1992-1995

	Actual 1992	Estimated ^a 1993	Forecast	
			1994	1995
Fourth Quarter to Fourth Quarter (Percentage change)				
Nominal GDP				
CBO	6.7	4.9	5.7	5.4
Administration	6.7	5.0	5.8	5.6
Blue Chip	6.7	5.5	5.7	5.8
Real GDP ^b				
CBO	3.9	2.3	2.8	2.7
Administration	3.9	2.3	3.0	2.7
Blue Chip	3.9	3.2	3.0	2.7
Consumer Price Index ^c				
CBO	3.1	2.7	2.9	3.0
Administration	3.1	2.9	3.0	3.2
Blue Chip	3.1	2.7	3.0	3.4
Calendar Year Averages (Percent)				
Civilian Unemployment Rate ^d				
CBO	7.4	6.8	6.8	6.5
Administration	7.4	6.8	6.9	6.5
Blue Chip	7.4	6.8	6.4	6.1
Three-Month Treasury Bill Rate ^e				
CBO	3.4	3.0	3.5	4.3
Administration	3.5	3.0	3.4	3.8
Blue Chip	3.4	3.0	3.7	4.3
Ten-Year Treasury Note Rate				
CBO	7.0	5.9	5.8	6.0
Administration	7.0	5.9	5.8	5.8
Blue Chip	7.0	5.9	6.3	6.6

SOURCES: Congressional Budget Office; Office of Management and Budget (OMB); Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (April 10, 1994).

NOTE: The CBO and OMB forecasts are based on data available through December 1993 and do not reflect the fourth-quarter data for gross domestic product (GDP). The *Blue Chip* forecast is an average of 50 private forecasters.

a. The *Blue Chip* forecast was prepared three months later than the other forecasts, so the *Blue Chip* data for 1993 are actual.

b. Based on constant 1987 dollars.

c. The consumer price index for all urban consumers (CPI-U).

d. The Bureau of Labor Statistics changed the method for conducting the unemployment survey in January 1994, and the change increased the measured unemployment somewhat. The CBO and Administration forecasts for 1994 and 1995 are consistent with the old, pre-1994, methodology. The forecast tables reported here have been adjusted upward 0.4 percentage points to make the forecasts comparable with currently published figures. Data for 1992 and 1993, shown in italics, use pre-1994 methodology.

e. CBO and *Blue Chip* project the secondary market rate for three-month Treasury bills, while OMB projects the auction average rate.

f. *Blue Chip* does not project a 10-year note rate. The values shown here for the 10-year note rate are based on the *Blue Chip* projections of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year Treasury notes.

Table 8.
Comparison of Federal Reserve, Congressional Budget Office,
and Administration Economic Projections for 1994

	Federal Reserve ^a	CBO	Administration
Fourth Quarter to Fourth Quarter (Percentage change)			
Nominal Gross Domestic Product	5.50 to 6.00	5.7	5.8
Real Gross Domestic Product	3.00 to 3.25	2.8	3.0
Consumer Price Index	About 3	2.9	3.0
Average Level, Fourth Quarter			
Civilian Unemployment Rate	6.50 to 6.75	6.6	6.8

SOURCES: Congressional Budget Office; Office of Management and Budget; Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress Pursuant to the Full Employment and Balanced Growth Act of 1978* (February 1994).

a. The Federal Reserve figures are the ranges--known as the central tendency--that include the majority of the forecasts of Federal Open Market Committee members and other Federal Reserve Bank presidents.

the end of 1993 represents (1) a sizable increase in spending on producers' durable equipment, which grew at an annual rate of 26 percent during the fourth quarter, compared with 10 percent in the third quarter; (2) an increase in demand for U.S. exports, which in turn increased the net export component of total demand much more than anticipated; and (3) a 15 percent increase in spending for consumer durables--more than double its growth in the third quarter.

Although the economy's recent surge embodied some strong fundamentals, CBO does not anticipate that this spell of rapid growth will presage similarly rapid growth throughout 1994. The Southern California earthquake and adverse winter weather cut into economic activity in the first quarter. Economic growth this year will be dampened by slightly more restrictive fiscal policy. The Omnibus Budget Reconciliation Act of 1993 imposed higher tax rates on high-income individuals and will slow the growth of federal expenditures. Moreover, continued weakness in the economies of some of its major trading partners is likely to moderate economic activity in the United States. More specifically, several countries have assigned high priority to containing growing public debt and budget deficits de-

spite their current recessionary environment; in all likelihood, this restraint abroad will limit demand for U.S. exports in 1994.³

Monetary policy is also likely to be less accommodative this year. In early February, a time when concerns about future inflation were rising, the Federal Reserve lifted the federal funds rate by 25 basis points. This was followed by a further rise of 25 basis points in the funds rate in late March. These actions were generally anticipated in both CBO's and the Administration's forecasts. The rise signalled a major turning point in the policy of the Federal Reserve, which has been relatively accommodative during the past five years. The change in policy probably foreshadows further increases in short-term interest rates as the economic expansion in the United States continues.

3. For the Group of Seven industrialized countries (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) combined, the Organization for Economic Cooperation and Development predicts that, on average, fiscal policy will be as restrictive as that of the United States. Also note that while a stimulative fiscal package has been accepted in Japan, the recovery is expected to be gradual, since the stimulus is primarily based on an income tax cut that is temporary and financing decisions have been postponed until the end of 1994.

Table 9.
Comparison of Congressional Budget Office, Administration, and *Blue Chip* Economic Projections, Calendar Years 1993-1999

	Estimated ^a 1993	Forecast		Projected			
		1994	1995	1996	1997	1998	1999
Nominal GDP (Billions of dollars)							
CBO	6,370	6,730	7,099	7,483	7,880	8,287	8,700
Administration	6,371	6,736	7,118	7,522	7,950	8,400	8,870
Real GDP ^b (Percentage change, year over year)							
CBO	2.8	2.9	2.7	2.7	2.7	2.6	2.5
Administration	2.8	3.1	2.8	2.7	2.6	2.6	2.5
<i>Blue Chip</i>	3.0	3.6	2.8	2.6	2.5	2.4	2.8
GDP Deflator (Percentage change)							
CBO	2.6	2.7	2.7	2.6	2.5	2.5	2.5
Administration	2.6	2.6	2.8	2.9	3.0	3.0	3.0
<i>Blue Chip</i>	2.6	2.3	2.9	3.2	3.2	3.1	3.1
Consumer Price Index ^c (Percentage change, year over year)							
CBO	3.0	2.7	3.0	3.1	3.1	3.1	3.1
Administration	3.0	2.8	3.2	3.3	3.3	3.4	3.4
<i>Blue Chip</i>	3.0	2.8	3.3	3.4	3.5	3.4	3.4
Civilian Unemployment Rate (Percent) ^d							
CBO	6.8	6.8	6.5	6.3	6.2	6.1	6.1
Administration	6.8	6.9	6.5	6.3	6.1	5.9	5.9
<i>Blue Chip</i>	6.8	6.5	6.2	6.0	6.1	6.1	6.0

SOURCES: Congressional Budget Office; Office of Management and Budget (OMB); Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1994).

NOTE: GDP = gross domestic product.

a. The *Blue Chip* forecast was prepared two month later than the other forecasts, so the *Blue Chip* data for 1993 are actual.

b. Based on constant 1987 dollars.

(Continued)

The Federal Reserve's forecast for this year is compatible with the near-term outlook delineated by the Administration and CBO forecasts (see Table 8). The Federal Reserve predicts only slightly higher real growth than does CBO or the Administration. At the same time, the Administration's forecast for unemployment in the comparable 1994 fourth quarter is just outside the Federal Reserve's upper boundary at 6.8 percent, while CBO's forecast of 6.6 percent is in the middle of the Fed's

range.⁴ Moreover, the Federal Reserve's projection for inflation has been lowered somewhat to "about 3" percent from the "3 to 3.5" percent given in July 1993.

4. The unemployment rates predicted by the Administration and CBO for the fourth quarter of 1994 were 6.4 and 6.2, respectively, on a prerevision basis. Both numbers were adjusted upward by 0.4 percentage points to make them roughly comparable to the Federal Reserve's forecast, which is based on the new methodology of the Bureau of Labor Statistics.

Table 9.
Continued

	Estimated ^a	Forecast		Projected			
	1993	1994	1995	1996	1997	1998	1999
Three-Month Treasury Bill Rate (Percent)^a							
CBO	3.0	3.5	4.3	4.6	4.6	4.7	4.7
Administration	3.0	3.4	3.8	4.1	4.4	4.4	4.4
<i>Blue Chip</i>	3.0	3.5	4.0	4.3	4.4	4.4	4.3
Ten-Year Treasury Note Rate (Percent)							
CBO	5.9	5.8	6.0	6.1	6.2	6.2	6.2
Administration	5.9	5.8	5.8	5.8	5.8	5.8	5.8
<i>Blue Chip</i> ^f	5.9	6.0	6.2	6.6	6.4	6.3	6.4
Nominal Income (Percentage of GDP)							
Wage and salary disbursements							
CBO	48.4	48.8	49.0	49.0	48.9	48.9	48.8
Administration	48.4	48.4	48.3	48.3	48.4	48.5	48.4
Other personal income^g							
CBO	36.1	36.1	36.4	36.7	37.0	37.4	37.7
Administration	36.1	36.1	36.2	36.3	36.4	36.6	36.7
Corporate profits^h							
CBO	7.0	7.0	6.6	6.4	6.3	6.2	6.1
Administration	7.0	7.5	7.5	7.4	7.2	7.1	7.1

c. Consumer price index for all urban consumers (CPI-U).

d. The Bureau of Labor Statistics changed the unemployment survey in January 1994. The CBO and Administration forecasts for 1994 through 1999 originally used 1993 methodology. The forecast tables reported here have been adjusted upward 0.4 percentage points to make the forecasts comparable with currently published figures. Data for 1993, shown in italics, use pre-1994 methodology.

e. CBO and *Blue Chip* project the secondary market rate for three-month Treasury bills, while OMB projects the auction average rate.

f. The *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year Treasury notes.

g. Personal income less wage and salary disbursements.

h. Corporate profits reported are book, not economic, profits.

The recent behavior of long-term interest rates, however, may indicate that financial markets anticipate more rapid acceleration of inflation than the Federal Reserve, Administration, and CBO forecasts indicate. Ten-year Treasury note rates, which averaged below 5.8 percent during January, rose to roughly 7 percent by early April. Inflationary expectations have probably been building since late last year. As previously mentioned, the data for the fourth quarter of 1993 and the first quarter of 1994 indicate that the economy is stronger than previ-

ously anticipated, despite severe winter weather. In addition, commodity price indexes have been rising steadily. This information increases the possibility that, by 1995, the economy will approach the point at which significant supply bottlenecks will appear. Inflation, it is feared, could then jump into the 4 percent to 5 percent range, just as it did in 1989.

Several factors indicate that inflation is likely to remain low in the near term, however. Oil prices in the first quarter of 1994 are about 10 percent lower

than they were in the last half of 1993. Lower oil prices will dampen the rise in input prices and contain price pressures in finished goods. Moreover, although fourth-quarter growth moved the economy closer to the limits of its capacity, CBO estimates that the GDP gap, a summary measure of the degree of excess capacity, will remain large enough to keep inflation steady even though economic growth remains close to 3 percent.⁵ In addition, CBO expects that there will be enough slack in the labor markets during the forecast period to keep unit labor costs--compensation growth adjusted for productivity gains--from rising rapidly. Furthermore, it is likely that more people will choose to enter the labor force as employment continues to grow. Faster growth of the labor force will slow the decline in the unemployment rate and curtail inflationary pressures from the labor market. Last, low inflation abroad will help to restrain U.S. inflation by keeping prices of imported goods low and holding down domestic price increases for U.S. goods.

Apart from inflationary expectations, other factors probably played a role in the rise in long-term rates. Long-term interest rates rose in early February against the backdrop of a monetary policy move by the Federal Reserve. The Federal Reserve's policy was apparently designed to dampen inflation expectations and long-term rates, but in fact, 10-year rates rose about three-fourths of a percentage point in almost two months after the policy action. The further increase in rates by the Federal Reserve in late March did little to allay these expectations.

At the same time, there has been a surge in long-term interest rates in Europe and Japan in 1994, even though economic conditions there differ from those in the United States. Some financial market analysts suggest that this unexpected behavior in the bond markets could have been the result of a massive sell-off by U.S. investors who originally invested abroad to capture higher yields when U.S. rates were low. Other analysts believe that some combination of economic uncertainties and

political tensions created uneasiness that resulted in the sell-off. Among the contributing factors were rapid growth in the German money supply; uncertainty about U.S. inflation and future Federal Reserve actions; the debt-financed fiscal stimulus in Japan that is expected to put upward pressure on long-term rates; trade frictions between the United States and Japan; and political uncertainties in Mexico, North Korea, China, and Russia.

Medium-Term Projections

The Administration and CBO outlooks for real GDP growth and unemployment are virtually identical for the 1996-1999 period.⁶ Both forecasts indicate that real GDP will grow at an average annual rate of about 2.6 percent, while unemployment is expected to decline only slightly from the levels forecast for 1995 (see Table 9 and Figure 1).

The significant differences in the medium-term projections lie in the outlook for inflation-adjusted interest rates. CBO predicts that inflation will average 3.1 percent over the 1996-1999 period, and the Administration projects that inflation will average 3.4 percent. CBO's interest rate projections, by contrast, are about 0.4 percentage points higher than those of the Administration. Consequently, the Administration's projections for interest rates, adjusted for inflation, are significantly lower than CBO's projections, which tends to lower the estimated deficits for the medium term. If the Administration projected higher nominal interest rates--high enough to result in inflation-adjusted rates similar to those projected by CBO--its deficit projections would be more than \$20 billion greater by 1999.

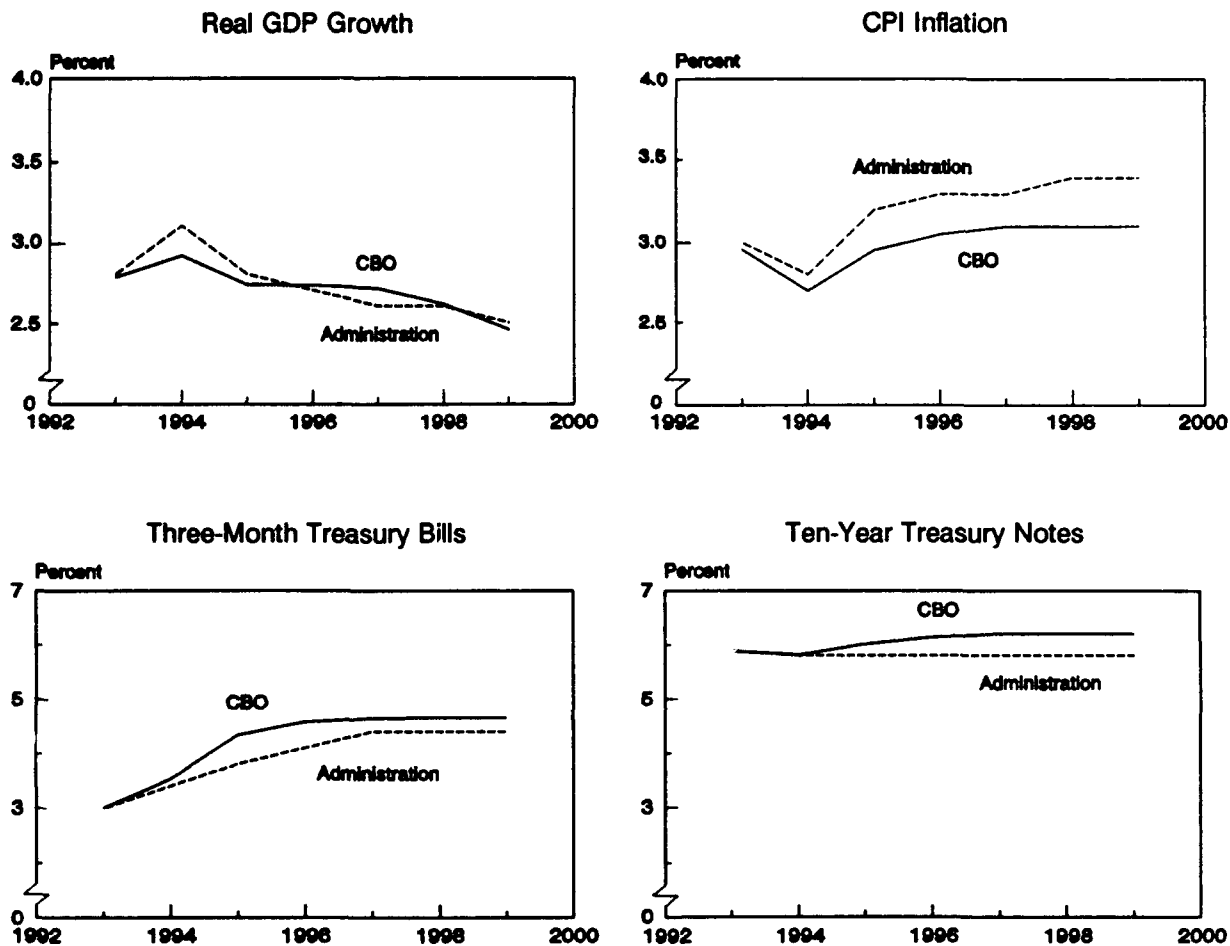
Interest Rates Adjusted for Inflation

Real short-term rates, approximated by the difference between the three-month Treasury bill rate and the average annual growth in the consumer price

5. It should be noted, however, that estimates of the GDP gap are highly uncertain. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1995-1999*, pp. 17-20.

6. The medium-term projections of CBO, the Administration, and the *Blue Chip* consensus do not attempt to forecast cyclical fluctuations beyond 1995. These projections are based on long-run trends extrapolated from recent developments.

Figure 1.
Comparison of Congressional Budget Office and Administration
Economic Assumptions



SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: GDP = gross domestic product; CPI = consumer price index for all urban consumers.

index over the following quarter, are relatively low and widely expected to rise. Neither CBO nor the Administration, however, expects real short-term rates to rise to the heights that prevailed in the mid-1980s. CBO estimates that real short-term rates will be 0.6 percentage points higher in the 1998-1999 period than the Administration's estimate.

Several factors suggest that short-term real rates will generally be higher in the next decade than they were during the 1953-1982 period when they

averaged 1 percent (see Figure 2).⁷ Most important, despite the progress in deficit reduction embodied in OBRA-93 and the President's budget, the deficit will still bulk larger in relation to GDP than it did in the 1950s, 1960s, and 1970s. In those years, the total federal deficit averaged just 1.1 percent of GDP, but by both CBO's and the Administration's

7. This period is chosen for reference in order to facilitate comparison with the discussion of inflation-adjusted interest rates in the *Economic Report of the President* (February 1994), p. 81.

projections, the deficit will average 2.5 percent of GDP over the next six years. The higher federal borrowing comes, moreover, out of a domestic capital pool that reflects substantially lower private saving. Gross saving by businesses and households averaged 17.3 percent of GDP between 1953 and 1982, but fell sharply in the mid-1980s and has recently been averaging about 15.8 percent of GDP. The continued high level of government borrowing, combined with low private saving, suggests some upward pressure on interest rates compared with the 1953-1982 period.

Some analysts note, however, that since the United States operates in an international capital market, its interest rates can be dampened by international sources of financing. On examination, this offset is unlikely to be large. World interest rates are likely to be substantially higher in the mid-1990s, when the European countries and Japan are likely to have recovered from their current economic difficulties. CBO has long anticipated that world capital demands, driven by development needs in Germany, Eastern Europe, and the former Soviet Union, are likely to increase. The North American Free Trade Agreement is also likely to encourage capital investment in Mexico, although

this demand will be small in relation to the size of the world capital market.

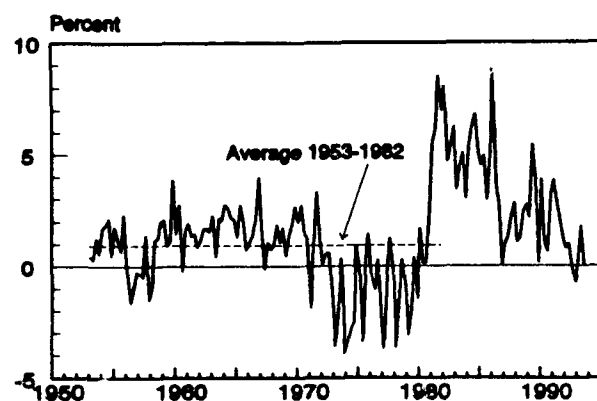
None of these factors are easily quantifiable, but all point to higher interest rates (in relation to inflation) in the 1990s than in the 1953-1982 period. Moreover, this earlier time period may be somewhat misleading as a standard of comparison; it includes a substantial period in the 1970s when real short-term interest rates fell below zero--the result of a combination of stimulative monetary policy and inflation that frequently exceeded expectations (see Figure 2). Few analysts would expect a return to such an extended period of negative real rates when the economy is expanding, and even fewer would advocate it. A more prudent projection, therefore, would set real short-term rates at a level somewhat above those prevailing in the 1953-1970 period, when real rates on short-term Treasury bills averaged 1.3 percent.

Labor Productivity and Unit Labor Costs

The medium-term projections of CBO and the Administration for labor productivity growth are virtually identical, a major reason for the similarity of real growth projections (see Table 10). Accelerating from the 1970s and 1980s, productivity will grow at an average annual rate of 1.4 percent from the third quarter of 1990 to the fourth quarter of 1999, according to CBO's projections, and will return to its long-term trend. This rate of growth is associated in part with a surge in investment in plant and equipment that CBO believes will be the wellspring of economic growth for the next few years. Investment will be stimulated primarily by corporate restructuring and the need to innovate. Besides the gains in manufacturing, recent anecdotal evidence suggests that accelerating investment will enhance productivity in services such as communications, insurance, banking, and finance.

Many economists believe that gains in productivity have held inflation in check during the past two years. An increase in the growth of productivity, given wage growth, implies a smaller rise in unit labor costs; because unit labor costs account for approximately two-thirds of total production ex-

Figure 2.
Quarterly Real Short-Term Interest Rates



SOURCE: Congressional Budget Office.

NOTE: The real short-term rate equals the three-month Treasury bill rate minus the next quarter's consumer price index.

Table 10.
Growth in Labor Productivity in the Nonfarm Business Sector (In percent)

Period	Average Annual Growth Rate
Actual Growth	
1960:II to 1973:IV	2.3
1973:IV to 1981:III	0.6
1981:III to 1990:III	0.9
1960:II to 1990:III	1.5
Projected Growth: 1990:III to 1999:IV	
Congressional Budget Office	1.4
Administration	1.5

SOURCES: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

NOTE: 1960:II, 1973:IV, 1981:III, and 1990:III are National Bureau of Economic Research cyclical peaks.

penses in the United States, they can help hold down price pressures in the economy. Although total compensation per hour (wages, salaries, and benefits) grew by 3.6 percent in 1993, unit labor costs grew by only 2.1 percent because of the offsetting gain of 1.6 percent in productivity growth.

Economic Implications of Health Care Reform

The Administration's health care reform proposal was not accounted for in either CBO or Administration economic projections. CBO believes that the main effect on the economy during the next few years could come from the proposal's excise tax on cigarettes and other tobacco products, applied in the fourth quarter of 1994. The tax could cause a one-time increase in the level of the consumer price in-

dex of approximately 0.6 percent, temporarily raising inflation. Although the Administration's economic projections generally predict higher inflation than those of CBO, the effect of this tax increase does not appear in the Administration's forecast for 1995.

Additional effects that could have an impact on the total economy as early as 1996 are difficult to quantify. Eventually, the proposal would cut total business spending on health insurance, but the effects would be uneven and some firms would face cost increases.⁸ Since the firms that face cost increases might not be able to reduce the nominal wages of their workers, their prices could be slightly higher for a time. Moreover, the incentives of the plan would encourage some workers to leave the labor force. This reduction in labor supply would reduce actual and potential output over the longer term, but only by very small amounts. In CBO's best judgment, the net effects of the Administration's health plan on the economic projections are small. Thus, the projections over the medium term will not be materially affected.

Effect of CBO's Economic Projections on the Administration's Budget

Other economic assumptions can have a significant impact on budget deficit projections. When CBO's economic assumptions are substituted for those of the Administration, the estimated deficits are increased in every year except 1994 (see Table 11).

The difference between the CBO and Administration deficit projections is primarily the result of disparities in inflation and interest rate assumptions. CBO's lower inflation forecast decreases taxable incomes and tax revenues. Moreover, lower inflation projections decrease outlays for benefits that are influenced by cost-of-living adjustments. These inflation effects do not offset each other, however.

8. See Congressional Budget Office, *An Analysis of the Administration's Health Proposal* (February 1994).

CBO's higher interest rate projections result in a net increase in outlays from higher interest costs in financing government expenditures and servicing the

debt. The combination of lower receipts and higher outlays, therefore, adds \$99 billion to the deficits over the 1994-1999 period.

Table 11.
Effects of CBO's Economic Projections on Estimates of the Administration's Budget (Differences by fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999	Cumulative Six-Year Change
Revenues ^a	-1	1	5	12	22	34	73
Outlays							
Benefit programs	-1	-1	-2	-3	-4	-6	-16
Net interest							
Due to higher interest rates	-1	1	6	8	9	11	34
Due to additional debt- service costs	<u>b</u>	<u>b</u>	<u>b</u>	<u>1</u>	<u>2</u>	<u>4</u>	<u>8</u>
Total	-2	b	5	5	7	10	26
Deficit	-2	1	10	17	29	43	99

SOURCE: Congressional Budget Office.

a. Revenue losses are shown as positive because they increase the deficit.

b. Less than \$500 million.

The Administration's Defense Budget

The budget request for 1995 represents the Clinton Administration's effort to match financial resources with its strategy for national security in the post-Cold War world. It comes on the heels of former Defense Secretary Les Aspin's Bottom-Up Review of force requirements. To fund that force, the Administration's defense budget calls for appropriations totaling \$264 billion for 1995. Outlays in 1995 would total about \$272 billion—an amount that exceeds the appropriation request because much of the outlay total reflects past appropriations that have been at higher levels.

Most of the transition to the lower force levels of the Bottom-Up Review will be accomplished by 1996 when the force will consist of 1,496,000 active-duty troops, declining to 1,453,000 in 1999. In nominal terms, budget authority would bottom out at \$253 billion in 1997 before returning to a level of \$266 billion in 1999—which is about 10 percent lower than in 1995 after adjusting for inflation. Outlays would level off at about \$257 billion for the three years from 1997 through 1999, again reflecting the pattern of budget authority in previous years.

The current budget plan has two clear risks: that inflation will be higher than planned and that anticipated savings from base closings and other cuts in infrastructure will not materialize. Moreover, the defense budget contains reductions in budget authority and outlays that remain to be specified in future budgets.

Priorities in the Current Request

The Administration points to readiness as its top priority in the defense budget, and it also assigns a high priority to science and technology programs designed to keep the qualitative advantage enjoyed by U.S. weaponry. Consequently, operation and maintenance (O&M) and research, development, test, and evaluation (RDT&E) are the only major portions of the defense budget receiving more money than is needed to cover the costs of inflation in 1995. After 1995, the plan calls for substantial increases in funding for weapons purchases.

Maintaining Readiness

Readiness is a term reserved for programs that contribute to the immediate effectiveness of weapons and forces.¹ It involves such activities as the training provided to individuals and units as well as the resources committed to keeping existing weapons in working order. The O&M accounts incur most of these costs, but O&M is not synonymous with readiness. For example, building maintenance

1. For more information, see Congressional Budget Office, "Trends in Selected Indicators of Military Readiness, 1980 Through 1993," CBO Paper (March 1994).

and environmental programs do not contribute to readiness despite their overall value. Nevertheless, the Administration strives to enhance readiness through its budget for 1995 by requesting \$3.3 billion, or about 4 percent, more in real terms than the 1994 budget for O&M programs.

As shown in Table 12, the growth in O&M funding would come to a halt in 1996. In fact, these accounts would suffer real declines through 1999, since nominal funding is nearly frozen through 1998 and grows a bit more in 1999, but by less than the expected costs of inflation. The Administration does not expect this funding restraint in

O&M to cause any shortfall in readiness as measured by the time military forces spend using or maintaining their equipment. Rather, the Administration expects to achieve substantial savings from cutting forces, closing bases, and reducing other elements of the Department of Defense's (DoD's) infrastructure funded through O&M accounts.

Technological Superiority

The fortunes of the Defense Department's RDT&E accounts generally indicate the priority given to improving the overall quality of U.S. weaponry. In

Table 12.
The President's Budget for National Defense for the 1995-1999 Period as
Estimated by CBO (By fiscal year, in billions of dollars)

Discretionary Account	1994	1995	1996	1997	1998	1999
Budget Authority						
Military Personnel	70.8	70.5	66.2	65.7	66.1	67.3
Operation and Maintenance	88.0	92.9	88.0	88.0	88.5	90.6
Procurement	44.5	43.3	48.4	49.8	57.1	60.1
RDT&E	34.8	36.2	34.8	32.1	30.9	30.2
Other Discretionary Programs	23.6	21.5	24.9	22.3	21.6	20.7
Future Adjustments	<u>0</u>	<u>0</u>	<u>-6.4</u>	<u>-5.4</u>	<u>-5.0</u>	<u>-3.3</u>
President's 1995 Budget as Estimated by CBO	261.5	264.3	255.9	252.6	259.2	265.7
Outlays						
Military Personnel	71.0	70.3	66.2	65.5	65.9	67.0
Operation and Maintenance	88.3	88.4	88.4	87.6	87.9	89.6
Procurement	60.8	55.1	49.3	48.7	49.9	52.8
RDT&E	35.5	36.1	35.2	33.4	31.7	30.6
Other Discretionary Programs	24.2	21.8	22.3	22.8	23.1	23.2
Future Adjustments	<u>0</u>	<u>0</u>	<u>0.2</u>	<u>-1.0</u>	<u>-1.4</u>	<u>-5.1</u>
President's 1995 Budget as Estimated by CBO	279.8	271.7	261.6	257.0	257.1	258.1

SOURCE: Congressional Budget Office.

NOTE: RDT&E = research, development, test, and evaluation.

1995, total growth in RDT&E funding would outpace inflation by about \$0.5 billion, or slightly more than 1 percent. This increase is about evenly split between pure science and technology and research into ballistic missile defenses (BMD); both programs would receive \$0.3 billion more than is necessary to cover inflation—about 4 percent in real growth for science and technology and about 11 percent for BMD. Funding for all other RDT&E programs would suffer a real decline of about 1 percent in 1995.

Like O&M funding, the relative priority enjoyed by RDT&E accounts would erode in 1996 and every year through 1999. By 1999, funding would total \$30.2 billion, or 25 percent less in real terms than the \$34.8 billion provided for 1994. By 1999, the change in emphasis within total RDT&E funding would be more dramatic; science and technology programs would continue to receive 4 percent more than the inflation-adjusted 1994 level, while BMD would be 5 percent lower, and all other RDT&E would be 36 percent lower.

Purchases of Weapons

The budget for purchases of new weapons dips in 1995 for the 10th straight year, but it recovers in 1996 and exceeds the inflation-adjusted 1994 level by \$9 billion in 1999. As the number of divisions, ships, and air wings has fallen, DoD has had more weapons than it needs for post-Cold War threats. Consequently, it can defer purchases of new equipment. The Administration's plan would replace obsolete equipment selectively. The modernization program is most evident in the plan for aircraft procurement for the Navy and Air Force, shipbuilding, Air Force space programs, and upgrades to Abrams tanks.

The procurement budget also aims at preserving the industrial capacity of the United States to produce critical items. The Administration cites the capability to produce nuclear-powered ships in its request to use \$3.7 billion to build an aircraft carrier; it also wants \$3 billion through 1999 for 19 cargo ships in further recognition of industrial as well as mobility needs. Other critical items for which production capabilities would be preserved

include tracked combat vehicles, such as Bradley Fighting Vehicles and Abrams tanks, and ammunition.

Procurement Reform

The Administration's overall budget anticipates savings of \$0.7 billion in 1995 and \$3 billion a year by 1999 from changing the way the federal government buys things. Drawing on the National Performance Review led by Vice President Gore, the Administration seeks to "reinvent" federal procurement practices, which affect the Defense Department far more than any other agency and almost as much as the rest of the government combined. Nevertheless, the original budget request did not show savings for any particular agency; rather, the amounts that the Administration expects to save from procurement reform are left undistributed in a consolidated account in function 920. Recently, however, the Administration indicated that procurement reform would lower its request for DoD by \$315 million. The amendment for 1995 distributes to DoD almost 45 percent of the expected savings and suggests that in 1999 DoD's budget authority could be about \$1.4 billion lower.

Still, the budgetary effects of procurement reform are most uncertain. The Congressional Budget Office is unable to estimate the savings from recent and wide-ranging proposals to change laws affecting government contracts, including negotiations, administration, reporting, and product development. Clearly, changes that lead to greater use of commercial items (in contrast to items designed to federal specifications) and to less onerous demands on the accounting systems of contractors would offer budgetary savings. The amount of savings, however, has escaped objective measurement by the Congressional Budget Office and other institutions.

The Risk of Higher Inflation

Inflation stands as the most obvious threat to the viability of the current defense budget and the

forces it would support. A year ago, the Administration and CBO projected that inflation over the 1995-1999 period would average about 2.2 percent. Now, both expect inflation as measured by the implicit GDP deflator to be a bit higher over that period--2.5 percent a year for the CBO forecast and 3.0 percent a year for the Administration's (see Table 13). The cost to defense programs of the Administration's new inflation forecast is about \$20 billion over the five years.

Yet despite the new estimates of inflation, the Administration has held its total defense budget down instead of revising a real program that may have to be further revised each year as the inflation projections change. Not using the new assumptions now has a cost to programs in 1995, but fortunately the first year's cost is relatively small--about \$0.4 billion.

Federal pay policies pose another price-related risk to the DoD budget. Last year, the Administration proposed to freeze federal salaries--both military and civilian--in 1994 and to reduce the future rates of increase relative to current law. The Congress, however, insisted that pay not be frozen in 1994, forcing other defense programs to bear the

costs--about \$1.8 billion in 1994 and more than \$2 billion a year thereafter.

A similar risk looms for 1995 through 1999 as the Administration proposes to hold military and civilian pay raises below those called for under current law (see Table 14). DoD's budget includes just enough money to provide its employees with an across-the-board pay raise equal to the change in the employment cost index less 1.5 percentage points. That amount is less than what current law provides for across-the-board raises by 1 full percentage point each year.

Moreover, as discussed in Chapter 1, current law holds that civilian employees receive locality-based raises designed to close the gap gradually between federal and nonfederal salary levels. The Administration's budget includes funds for salary growth, but does not distinguish between across-the-board and locality pay raises. If the Congress adheres to current law only on across-the-board pay raises, then DoD would need about \$15.9 billion more. Adhering to current law also on locality pay would add another \$12.1 billion. If the additional funding was not available, DoD would have to cut back on other expenses.

Table 13.
Estimated Increases in the GDP Deflator (By fiscal year, in percentage change)

	1995	1996	1997	1998	1999
Administration and CBO Estimates of a Year Ago	2.3	2.3	2.2	2.2	n.a.
Current CBO Estimates	2.7	2.6	2.5	2.5	2.5
Current Administration Estimates	2.8	2.9	3.0	3.0	3.0

SOURCES: Congressional Budget Office and the Department of Defense.

NOTE: n.a. = not available.

The Risk of Not Cutting Infrastructure

The second risk to the Administration's plan is that DoD will not be able to reduce its infrastructure as quickly as it is planning. Funding to meet infrastructure costs are found mostly in the O&M accounts, where most readiness activities are also funded. Infrastructure costs for this purpose are defined as the costs of bases and other support activities that do not change as force levels change, much as business overhead does not readily change with the volume of sales.

Failure to realize the expected savings in infrastructure may threaten funding for readiness. For example, each year the Congress promotes readiness by funding force operating tempos (optempo) such

as flying hours for aircraft and steaming days for ships. In the Army, optempo is often expressed in terms of how many miles each tank could be driven, and for 1994 the Congress funded an optempo of 800 miles per tank. Nevertheless, other demands on its funding within the O&M account have forced the Army to cut its tank use to 620 miles. The plan for the 1995-1999 period calls for returning to 800 miles a tank a year, but that plan, like the 1994 plan, could be jeopardized by a failure to reduce infrastructure that causes the Army to restrict optempo.

How much are the expected savings? In 1999, the Administration's estimate for O&M falls short of the 1994 level by about \$10 billion in real terms. The force reductions of the Bottom-Up Review explain about half of this reduction, and the remainder can be attributed to expected savings in infrastructure.

Table 14.
Estimated Pay Raises for Military and Civilian Employees (By fiscal year, in percentage change)

	1995	1996	1997	1998	1999
Across-the-Board Pay Raises for Military Personnel					
Current Administration Policy	1.6	2.2	2.5	2.5	2.5
Current Law					
CBO estimates	2.6	3.0	3.2	3.0	2.8
Administration estimates	2.6	3.2	3.5	3.5	3.5
Across-the-Board and Locality Pay Raises for DoD Civilians					
Current Administration Policy	1.6	2.2	2.5	2.5	2.5
Current Law					
CBO estimates ^a	4.7	4.9	5.2	5.1	5.0
Administration estimates	n.a.	n.a.	n.a.	n.a.	n.a.

SOURCES: Congressional Budget Office and the Department of Defense.

NOTE: n.a. = not available.

a. These figures are weighted averages for various locations and employee categories.

Can the Defense Department find these savings? The evidence is mixed. DoD is now conducting the first three of four rounds of base closings. For the first two rounds, DoD is realizing O&M savings that overall are about 15 percent less than it estimated near the beginning of each round (the first round is saving more than expected, but the second round is saving less). The one-time costs of closing bases, borne elsewhere in DoD's budget, are running higher than expected. The jury is still out for both rounds, and the final results could be better or worse. Yet the first two rounds of base closures clearly demonstrate the uncertainty over savings estimates. Perhaps the Administration will pursue rounds three and four more vigorously and achieve greater savings sooner, but even then the savings offered by base closures alone may be insufficient to meet DoD's goals for infrastructure.

Whether the bases are closed or not, the effect on the budget may be much the same if DoD can lower its civilian payroll. Savings in O&M from closing bases stem primarily from lower employment of civilians (about one out of four DoD civilians works in a base support function.) In 1999, DoD would employ 129,000 fewer civilians than in 1994, and about 80,000 of these may serve in positions related to bases and other infrastructure, the rest being attributable to force reductions. Moreover, DoD's plan calls for achieving nearly 40 percent of the total cut projected for 1999--about 50,000 people--in 1995.

Recent experience suggests that DoD may be able to reduce its payroll as planned; in 1993, its payroll fell by nearly 70,000 civilians. If attrition alone is an inadequate device for managing the work force in terms of skills, hierarchy, and involuntary job loss, then DoD may also use separation incentives through 1997 to meet its goals.

Future Adjustments to the Defense Budget

The five-year plan for the defense budget actually exceeds what the Administration has pegged as the Pentagon's slice of the fiscal pie except for what it

calls "future adjustments." DoD's financial blueprint, which is shown in Table 12, calls for unspecified reductions of \$20.1 billion in budget authority and \$7.3 billion in outlays in the four years from 1996 through 1999.

The amount of budget authority approximates the total funding necessary to cover the change in inflation estimates, but the adjustments would occur in the wrong years. The difference in inflation assumptions would start out small in 1996 at about \$2 billion in budget authority and grow to about \$7.5 billion in 1999, as the costs of the assumptions of higher prices cumulate. By contrast, the Administration's "future adjustments" to budget authority start at \$6.4 billion in 1996 and dwindle to \$3.3 billion in 1999. Clearly, the future adjustments to budget authority indicate funding problems beyond the question of inflation estimates.

The future adjustments that the Administration expects to make to outlays show an apparent imbalance with the future adjustments to budget authority. First, the reduction in 1996 budget authority is paired with a slight increase in outlays for that year. Second, by 1998 the reduction in budget authority accumulates to about \$17 billion, while the outlay adjustments add to only \$2 billion for that period--an abnormally low number.

How will these future adjustments affect current priorities if the Administration adheres to its totals in budget authority and outlays for DoD? First, the increases in budget authority planned for weapons procurement could be cut back, with the effect of retarding plans to equip forces with new weaponry and sustain DoD's industrial base. But even then, there would still be room for programs generating immediate outlays such as O&M and RDT&E. By trading slow-spending budget authority for fast-spending budget authority, both targets can be met. Although weapons purchases could tumble by as much as \$30 billion through 1999, more money could be available for readiness and technology programs funded in O&M and RDT&E, which could increase by \$12 billion and \$2 billion, respectively, over the five years. Alternatively, the cuts in procurement could lead to higher pay raises for military and civilian employees if the Congress chose to continue with current law.

Appendixes

CBO Baseline Budget Projections

Throughout this study, the Administration's proposals are contrasted with the Congressional Budget Office's (CBO's) baseline estimates of the budget. The baseline shows the path of revenues and spending if current laws and policies remain unchanged. It is not a forecast of budget outcomes, since policymakers will certainly seek to alter current priorities. But the baseline is a handy yardstick for gauging the potential impacts of proposed changes--those advocated in the President's budget as well as in competing packages.

The Baseline Concept

Baseline projections follow long-established rules. Revenues and entitlement programs (like Social Security and Medicare) continue on their course until the Congress changes the laws that underpin them--laws that define taxable incomes and set tax rates, benefit formulas and eligibility, and so forth. For these categories, therefore, the baseline represents CBO's best estimate of what will happen in the absence of any changes to current laws.

Unlike entitlement programs, discretionary programs are funded anew each year through the appropriation process. Discretionary programs encompass nearly all spending for defense and international affairs plus many domestic programs: space, energy, highway and airport grants, environmental protection, health research, and the salaries and expenses of civilian agencies, to name just a few. The Budget Enforcement Act of 1990 set caps on aggregate spending for these programs for the 1991-1995 period, and the Omnibus Budget Reconciliation Act of 1993 imposed caps through 1998.

CBO's baseline assumes compliance with the caps, which, as explained below, will force trade-offs among many competing programs. No law specifies caps after 1998. Thus, the baseline projections for 1999 simply preserve discretionary spending at the same real level as in 1998, boosting it by about 3 percent solely for inflation.

Three categories of spending remain. The federal government has pledged to protect depositors in banks and savings and loan institutions, and the baseline for deposit insurance shows the net cost of meeting those promises. The category labeled off-setting receipts, which encompasses Medicare insurance premiums and similar fees and collections, represents CBO's best estimate of the amounts that the government will collect under current laws and policies. The last category is net interest, which is driven by market interest rates and future deficits rather than being directly controlled by policymakers; CBO estimates such spending consistent with its projections of those two fundamental determinants.

Baseline Projections

In January 1994, CBO published its baseline projections in *The Economic and Budget Outlook: Fiscal Years 1995-1999* and described the key factors that drive the federal government's revenues, spending, and deficit. Over the next two months, CBO revised its baseline projections modestly in the face of legislation and new information, and those revisions raise projected deficits in every year (see Table A-1). The California earthquake spurred additional funding for discretionary programs. A supplemental

appropriation, plus the release of previously approved funds that were contingent on the occurrence of such an emergency, will boost spending by an estimated \$2 billion to \$5 billion a year through 1996 and by smaller amounts thereafter. Because this aid is labeled an emergency and hence will be accommodated through an upward revision to the discretionary spending caps, CBO includes it here; the formal adjustment to the caps will not appear until the next Office of Management and Budget (OMB) sequestration report in August 1994.

Technical revisions stem not from legislation but from new information that came to light through late February, much of it contained in the President's budget and supporting documents. One such

revision reflects the decision by the Student Loan Marketing Association, nicknamed Sallie Mae, to repay some of its remaining debt to the government two years ahead of schedule. Because this collection is a receipt to the Treasury, CBO has pruned its projections of outlays by \$3 billion in 1994 but upped them by an equal amount in 1996. (Sallie Mae apparently elected to pay off even more of its debt in March, after CBO had completed its baseline projections and the House and Senate had started work on their budget resolutions; those extra repayments are not reflected here.)

Other revisions to spending are scattered. New information about spending plans and likely proceeds from liquidations has led CBO to revise its

Table A-1.

Changes in CBO Baseline Deficit Projections (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
January Baseline Deficit	223	171	166	182	180	204
Policy Changes (Discretionary spending)	3	5	2	a	a	a
Technical Revisions						
Student loan liquidating account	-3	a	3	a	a	a
Deposit insurance	1	-1	a	a	-1	a
Postal Service	a	1	1	1	a	a
Civil service retirement benefits	a	a	1	1	1	1
Military retirement contributions	a	a	1	1	1	1
Other mandatory spending and offsetting receipts	1	2	1	1	1	1
Discretionary spending	1	a	2	2	2	2
Net interest	<u>a</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>3</u>	<u>3</u>
Total	1	4	12	9	7	8
Total Changes	5	9	14	9	7	8
March Baseline Deficit	228	180	180	192	187	213

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

estimates of net spending by two deposit insurance agencies, the Resolution Trust Corporation and the Bank Insurance Fund, by small and roughly offsetting amounts. CBO now expects a larger deficit for the Postal Service Fund (as hikes in postage rates

will be smaller than CBO had earlier assumed), higher costs for civil service retirement, and smaller receipts for military retirement. Upward revisions of as much as \$2 billion a year in discretionary spending fundamentally reflect CBO's switch to the

Table A-2.
CBO Baseline Deficit Projections (By fiscal year)

	Actual 1993	1994	1995	1996	1997	1998	1999
In Billions of Dollars							
Total Deficit Assuming Discretionary Caps	255	228	180	180	192	187	213
Deficit Excluding Deposit Insurance	283	231	192	194	198	192	216
Standardized-Employment Deficit ^a	215	183	154	163	172	172	199
On-Budget Deficit (Excluding Social Security and Postal Service)	300	288	249	256	275	279	312
Memorandum:							
Deposit Insurance	-28	-3	-12	-14	-6	-5	-4
Off-Budget Surplus							
Social Security	46	62	70	75	84	92	99
Postal Service	<u>-1</u>	<u>-2</u>	<u>-1</u>	<u>1</u>	<u>b</u>	<u>-1</u>	<u>b</u>
Total, Off-Budget Surplus	45	60	69	76	84	91	100
Hospital Insurance Surplus	4	5	7	5	b	-5	-13
As a Percentage of GDP							
Total Deficit Assuming Discretionary Caps	4.0	3.4	2.6	2.4	2.5	2.3	2.5
Deficit Excluding Deposit Insurance	4.5	3.5	2.7	2.6	2.5	2.3	2.5
Standardized-Employment Deficit ^{a,c}	3.3	2.7	2.2	2.2	2.2	2.1	2.3

SOURCE: Congressional Budget Office.

a. Excludes cyclical deficit and deposit insurance.

b. Less than \$500 million.

c. Expressed as a percentage of potential GDP.

caps published by OMB in the President's budget--a switch that acknowledges that OMB's figures, not CBO's, are ultimately used in enforcing compliance with the caps. Finally net interest outlays are larger, chiefly because other revisions warrant an upward adjustment in CBO's estimates of future borrowing and hence debt-service costs. All told, technical

revisions add to deficits by an average of \$7 billion a year in 1994 through 1999.

The remaining tables in this appendix update some of the most widely used information in CBO's January report. Because the revisions are relatively minor, readers seeking a fuller explanation of un-

Table A-3.
CBO Baseline Budget Projections, Assuming Compliance
with Discretionary Spending Caps (By fiscal year)

	Actual 1993	1994	1995	1996	1997	1998	1999
In Billions of Dollars							
Revenues							
Individual income	510	547	596	635	668	708	748
Corporate income	118	128	130	133	138	144	148
Social insurance	428	468	499	526	551	578	604
Other	<u>98</u>	<u>107</u>	<u>113</u>	<u>118</u>	<u>122</u>	<u>126</u>	<u>130</u>
Total	1,154	1,251	1,338	1,411	1,479	1,556	1,630
On-budget	842	910	978	1,031	1,080	1,136	1,190
Off-budget	312	341	360	380	399	420	440
Outlays							
Discretionary							
Defense	292	280	273	277	283	291	298
International	22	21	21	21	22	22	23
Domestic	228	246	260	267	273	282	290
Unspecified reductions	<u>0</u>	<u>0</u>	<u>-8</u>	<u>-15</u>	<u>-30</u>	<u>-45</u>	<u>-46</u>
Subtotal	542	547	546	551	549	549	566
Mandatory	762	802	847	897	963	1,028	1,100
Deposit insurance	-28	-3	-12	-14	-6	-5	-4
Net interest	199	201	214	230	241	252	264
Offsetting receipts	<u>-67</u>	<u>-68</u>	<u>-77</u>	<u>-72</u>	<u>-76</u>	<u>-82</u>	<u>-85</u>
Total	1,408	1,478	1,518	1,591	1,670	1,743	1,843
On-budget	1,142	1,198	1,227	1,287	1,355	1,415	1,503
Off-budget	267	280	291	303	315	328	340
Deficit	255	228	180	180	192	187	213
On-budget deficit	300	288	249	256	275	279	312
Off-budget surplus	45	60	69	76	84	91	100

(Continued)

derlying trends in the budget can rely on that earlier publication.

Clearly, much of the concern about the budget stems from the sheer size of the federal deficit, and Table A-2 on page 39 displays several alternative measures of this gap. The most commonly used

measure of the deficit is simply the difference between total revenues and spending. But participants in the budget debate often cite other measures as well--most usefully, the standardized-employment or structural deficit. This figure shows what is left after removing the cyclical deficit--that is, the weakened revenues and extra benefit spending that result

Table A-3.
Continued

	Actual 1993	1994	1995	1996	1997	1998	1999
As a Percentage of GDP							
Revenues							
Individual income	8.1	8.2	8.5	8.6	8.6	8.6	8.7
Corporate income	1.9	1.9	1.9	1.8	1.8	1.8	1.7
Social insurance	6.8	7.1	7.1	7.1	7.1	7.1	7.0
Other	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>
Total	18.3	18.8	19.1	19.1	19.0	19.0	19.0
On-budget	13.4	13.7	14.0	14.0	13.9	13.9	13.8
Off-budget	5.0	5.1	5.1	5.1	5.1	5.1	5.1
Outlays							
Discretionary							
Defense	4.6	4.2	3.9	3.8	3.6	3.5	3.5
International	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Domestic	3.6	3.7	3.7	3.6	3.5	3.4	3.4
Unspecified reductions	<u>0</u>	<u>0</u>	<u>-0.1</u>	<u>-0.2</u>	<u>-0.4</u>	<u>-0.6</u>	<u>-0.5</u>
Subtotal	8.6	8.2	7.8	7.5	7.1	6.7	6.6
Mandatory	12.1	12.1	12.1	12.1	12.4	12.6	12.8
Deposit insurance	-0.4	-0.1	-0.2	-0.2	-0.1	-0.1	a
Net interest	3.2	3.0	3.0	3.1	3.1	3.1	3.1
Offsetting receipts	<u>-1.1</u>	<u>-1.0</u>	<u>-1.1</u>	<u>-1.0</u>	<u>-1.0</u>	<u>-1.0</u>	<u>-1.0</u>
Total	22.4	22.3	21.7	21.5	21.5	21.3	21.4
On-budget	18.1	18.1	17.5	17.4	17.4	17.3	17.5
Off-budget	4.2	4.2	4.2	4.1	4.1	4.0	4.0
Deficit	4.0	3.4	2.6	2.4	2.5	2.3	2.5
On-budget deficit	4.8	4.3	3.6	3.5	3.5	3.4	3.6
Off-budget surplus	0.7	0.9	1.0	1.0	1.1	1.1	1.2

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent of GDP.

when the economy operates below its potential. With the recovery on a solid footing, the distinction between the structural deficit and the conventionally measured deficit becomes less and less relevant.

Spending and receipts for a number of large programs are often tracked separately; chief among them are Social Security and the Postal Service (both of them off-budget under different statutory provisions) and Medicare's Hospital Insurance. The narrowly defined surpluses (or deficits) of these programs are depicted in Table A-2. Despite these programs' special status, they loom so large in the revenue and spending totals that any measure of the budget that omits them yields a distorted picture of the government's drain on credit markets and its role in the economy.

Federal government revenues by source and outlays by broad category, both in dollar terms and in relation to gross domestic product (GDP), are presented in Table A-3 on page 40. Spending for entitlements and other mandatory programs, by far the largest major spending category, tops \$800 billion a year and is growing fast. Table A-4 displays more information about this huge cluster of programs.

In its baseline projections, CBO assumes that policymakers will continue to abide by the discretionary spending limits set in law through 1998. Separate caps apply to both budget authority (the authority to commit funds, the basic currency of the appropriation process) and outlays (actual spending); the stricter constraint governs. The caps have no unique implications for particular programs but rather force a bruising competition for resources. A glance confirms that the outlay constraint will be tougher to satisfy than the budget authority constraint in the 1995 budget cycle. As Table A-5 on page 44 suggests, a virtual freeze on appropriations at this year's levels will be required to comply with the outlay caps in 1995, even though such a choice would seem to leave much of the permissible bud-

get authority unused. Specifically, the cap on outlays--estimated at \$546 billion--is far below the \$554 billion that would be spent if real appropriations remained at this year's level and barely above the \$543 billion in outlays that would result if appropriations were strictly frozen across the board.

According to CBO's projections, under current policies the deficit excluding deposit insurance is virtually flat in 1995 through 1998 but then jumps in 1999, the last year of the baseline. That spurt is not an aberration. By 1998, discretionary outlays, in dollar terms, will have been virtually frozen for six years in a row. But the caps on discretionary spending expire after 1998. If the programs governed by the caps then resume growing--even if they grow no faster than is needed to keep pace with inflation--the deficit is likely to climb, not just in 1999 but in later years as well (see Table A-6 on page 45).

Long-range budget projections are highly uncertain because no one can foresee the path of the economy or such important trends as growth in health care spending. CBO's long-run extrapolations thus contain considerably less detail than its five-year projections, which are required under the Congressional budget process. Nevertheless, CBO's broad-brush overview suggests that after 1998--in the absence of concerted action by policymakers--the deficit is likely to continue climbing both in dollar terms and, more worrisomely, as a percentage of GDP. Sustained growth in the two big health care programs, Medicare and Medicaid, is the major reason, as they mount steadily from 3.7 percent of GDP today to 6.3 percent of GDP in 2004. Most other spending programs, along with federal revenues, are expected to be roughly flat as a percentage of GDP over the 10-year period. The exception, discretionary spending, drops precipitously (relative to GDP) through 1998. In 1999 and beyond, its fall is less steep and is no longer sufficient to overcome the steady upward pressure from health-related spending.

Table A-4.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance
(By fiscal year, in billions of dollars)

	Actual 1993	1994	1995	1996	1997	1998	1999
Means-Tested Programs							
Medicaid	76	86	96	108	121	135	151
Food Stamps ^a	25	25	26	27	28	29	30
Supplemental Security Income	21	25	24	24	29	32	35
Family Support	16	17	18	18	19	20	20
Veterans' Pensions	4	3	3	3	3	3	3
Child Nutrition	7	7	7	8	8	9	9
Earned Income Tax Credit	9	11	15	18	20	21	22
Student Loans	2	2	2	2	2	2	2
Other	<u>3</u>	<u>3</u>	<u>3</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>5</u>
Total, Means-Tested Programs	162	180	196	212	234	254	277
Non-Means-Tested Programs							
Social Security	302	318	335	352	370	388	408
Medicare	<u>143</u>	<u>160</u>	<u>177</u>	<u>195</u>	<u>216</u>	<u>238</u>	<u>263</u>
Subtotal	445	478	512	547	585	626	671
Other Retirement and Disability							
Federal civilian ^b	39	40	42	44	46	49	51
Military	26	26	27	29	30	32	35
Other	<u>4</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>4</u>
Subtotal	69	71	74	78	81	86	90
Unemployment Compensation	35	27	24	25	25	26	27
Other Programs							
Veterans' benefits ^c	17	18	17	16	18	18	19
Farm price supports	16	11	7	8	8	8	9
Social services	5	6	6	6	6	6	5
Credit reform liquidating accounts	2	-1	-1	-4	-5	-5	-6
Other	<u>11</u>	<u>13</u>	<u>11</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>8</u>
Subtotal	51	46	41	35	37	37	36
Total, Non-Means-Tested Programs	600	622	651	685	729	774	824
Total							
All Mandatory Spending, Excluding Deposit Insurance	762	802	847	897	963	1,028	1,100

SOURCE: Congressional Budget Office.

NOTE: Outlays for most of the benefit programs shown above do not include administrative costs, which are classified as domestic discretionary spending. Outlays for Medicare do not include premium collections, which are classified as offsetting receipts.

- a. Includes nutrition assistance to Puerto Rico.
- b. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
- c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Table A-5.
How Tight Are the Discretionary Caps? (By fiscal year, in billions of dollars)

	1995	1996	1997	1998
Budget Authority				
Discretionary Caps ^a	518	519	530	533
Amount Needed to Preserve 1994 Real Resources				
Defense	269	278	287	295
International	21	22	22	23
Domestic	<u>227</u>	<u>240</u>	<u>248</u>	<u>261</u>
Total	518	540	557	579
Amount over or under (-) caps	-1	20	27	45
Amount Needed to Freeze 1994 Dollar Resources				
Defense	260	260	260	260
International	20	20	20	20
Domestic	<u>220</u>	<u>225</u>	<u>226</u>	<u>232</u>
Total	501	506	507	513
Amount over or under (-) caps	-17	-13	-22	-21
Outlays				
Discretionary Caps ^a	546	551	549	549
Amount Needed to Preserve 1994 Real Resources				
Defense	273	277	283	291
International	21	21	22	22
Domestic	<u>260</u>	<u>267</u>	<u>273</u>	<u>282</u>
Total	554	565	578	595
Amount over or under (-) caps	8	15	30	45
Amount Needed to Freeze 1994 Dollar Resources				
Defense	267	264	261	261
International	21	20	21	20
Domestic	<u>255</u>	<u>255</u>	<u>255</u>	<u>256</u>
Total	543	539	536	537
Amount over or under (-) caps	-4	-11	-12	-13

SOURCE: Congressional Budget Office.

NOTE: Amounts needed to preserve 1994 real resources include adjustments for inflation of about 3 percent a year. Amounts needed to freeze 1994 dollar resources include no adjustment for inflation. Both paths include the budget authority necessary to renew expiring contracts for subsidized housing.

a. The estimated caps are based on those published in Office of Management and Budget, "Budget Enforcement Act Preview Report," in *Budget of the United States Government: Analytical Perspectives* (February 1994), as modified by CBO for expected adjustments.

Table A-6.
The Budget Outlook Through 2004 (By fiscal year)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
In Billions of Dollars											
Revenues	1,251	1,338	1,411	1,479	1,556	1,630	1,706	1,783	1,868	1,958	2,054
Outlays											
Discretionary	547	546	551	549	549	566	584	602	621	640	660
Mandatory											
Social Security	318	335	352	370	388	408	429	450	473	497	523
Medicare	160	177	195	216	238	263	290	320	354	391	434
Medicaid	86	96	108	121	135	151	168	186	206	227	250
Civil Service and Military Retirement	62	65	68	71	74	79	82	86	90	94	99
Other	176	174	174	185	192	199	206	212	219	226	233
Subtotal	802	847	897	963	1,028	1,100	1,175	1,255	1,342	1,436	1,538
Deposit insurance	-3	-12	-14	-6	-5	-4	-2	-2	-1	-1	-1
Net interest	201	214	230	241	252	264	276	291	307	325	345
Offsetting receipts	-68	-77	-72	-76	-82	-85	-88	-92	-95	-99	-104
Total	1,478	1,518	1,591	1,670	1,743	1,843	1,945	2,054	2,173	2,300	2,439
Deficit	228	180	180	192	187	213	240	271	305	343	385
Deficit Excluding Deposit Insurance	231	192	194	198	192	216	242	273	306	344	386
Debt Held by the Public	3,465	3,653	3,846	4,055	4,260	4,492	4,751	5,041	5,366	5,728	6,132
As a Percentage of GDP											
Revenues	18.8	19.1	19.1	19.0	19.0	19.0	18.9	18.9	18.8	18.8	18.8
Outlays											
Discretionary	8.2	7.8	7.5	7.1	6.7	6.6	6.5	6.4	6.3	6.1	6.0
Mandatory											
Social Security	4.8	4.8	4.8	4.8	4.7	4.7	4.8	4.8	4.8	4.8	4.8
Medicare	2.4	2.5	2.6	2.8	2.9	3.1	3.2	3.4	3.6	3.8	4.0
Medicaid	1.3	1.4	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.2	2.3
Civil Service and Military Retirement	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other	2.6	2.5	2.4	2.4	2.4	2.3	2.3	2.2	2.2	2.2	2.1
Subtotal	12.1	12.1	12.1	12.4	12.6	12.8	13.0	13.3	13.5	13.8	14.1
Deposit insurance	-0.1	-0.2	-0.2	-0.1	-0.1	a	a	a	a	a	a
Net interest	3.0	3.0	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.2
Offsetting receipts	-1.0	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9
Total	22.3	21.7	21.5	21.5	21.3	21.4	21.6	21.7	21.9	22.1	22.3
Deficit	3.4	2.6	2.4	2.5	2.3	2.5	2.7	2.9	3.1	3.3	3.5
Deficit Excluding Deposit Insurance	3.5	2.7	2.6	2.5	2.3	2.5	2.7	2.9	3.1	3.3	3.5
Debt Held by the Public	52.2	52.1	52.1	52.1	52.1	52.3	52.7	53.3	54.1	55.0	56.1

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent of GDP.

Appendix B

Major Contributors to the Revenue and Spending Projections

The following analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Corporate income taxes, Federal Reserve System earnings
Maureen Griffin	Social insurance contributions, excise taxes, estate and gift taxes
Matthew Melillo	Excise taxes, national income and product account receipts
Linda Radey	Excise taxes
Melissa Sampson	Customs duties, miscellaneous receipts
David Weiner	Individual income taxes

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Elizabeth Chambers	Military retirement, defense
Kent Christensen	Defense
Christopher Duncan	International affairs
Victoria Fraider	Veterans' benefits, defense
Raymond Hall	Defense
William Myers	Defense
Mary Helen Petrus	Veterans' compensation and pensions
Amy Plapp	Defense
Kathleen Shepherd	Veterans' benefits
Lisa Siegel	Defense
Joseph Whitehill	International affairs

Human Resources

Wayne Boyington	Civil Service Retirement, Railroad Retirement
Paul Cullinan	Social Security
Alan Fairbank	Hospital Insurance
Scott Harrison	Medicare
Jean Hearne	Medicaid
Lori Housman	Medicare
Julia Isaacs	Food stamps, foster care, child care
Deborah Kalcevic	Education
Lisa Layman	Medicare
Jeffrey Lemieux	Federal employee health benefits
Cory Oltman	Unemployment insurance, training programs
Pat Purcell	Supplemental Security Income, Medicaid
Dorothy Rosenbaum	Social service programs, Head Start
Connie Takata	Public Health Service
John Tapogna	Aid to Families with Dependent Children, child support enforcement

Natural and Physical Resources

Michael Buhl	General government, Postal Service
Kim Cawley	Energy, pollution control and abatement
Patricia Conroy	Community and regional development, natural resources, general government
Peter Fontaine	Energy, Outer Continental Shelf receipts
Mark Grabowicz	Science and space, justice
Theresa Gullo	Water resources, conservation, land management
James Hearn	General government, deposit insurance
David Hull	Agriculture
Mary Maginniss	Deposit insurance
Eileen Manfredi	Agriculture
Ian McCormick	Agriculture
Susanne Mehlman	Justice, Federal Housing Administration
David Moore	Spectrum auction receipts
John Patterson	Transportation
Deborah Reis	Recreation, water transportation
Judith Ruud	Deposit insurance
Brent Shipp	Housing and mortgage credit
John Webb	Commerce, disaster relief
Aaron Zeisler	Deposit insurance

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Jodi Capps	Appropriation bills
Karin Carr	Budget projections, historical data
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support

Glen Goodnow	Authorization bills
Leslie Griffin	Budget projections, civilian agency pay
Vernon Hammett	Computer support
Ellen Hays	Other interest, credit programs
Sandra Hoffman	Computer support
Jeffrey Holland	Net interest on the public debt, national income and product accounts
Deborah Keefe	Computer support
Terri Linger	Computer support
Fritz Maier	Computer support
Kathy Ruffing	Treasury borrowing, interest, and debt
Robert Sempsey	Appropriation bills